S. Hrg. 101-127, Pt. III

PROBLEMS OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION [FSLIC]

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE PROBLEMS IN THE SAVINGS AND LOAN INDUSTRY AND THE POTENTIAL THREAT TO THE INSURANCE FUND PROTECTING S&L DEPOSITS

PART III OF IV

MARCH 3, 7, 8, 9, AND 10, 1989

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
98-682 WASHINGTON : 1989

S 241-25

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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PROBLEMS OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION [FSLIC]

PART III OF IV

FRIDAY, MARCH 3, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Dixon, Graham, Bryan, D'Amato, and Pressler.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. Let me invite those in the room to find a seat and let me welcome Mr. Blum, our first witness today. I want to indicate at the outset that today's hearing that the Senate is in session at this time, and we have the Tower nomination on the Senate floor. A number of Senators have to be on the floor to participate in that debate, particularly those that are members of the Armed Services Committee. Senator Dixon is in such a position, although he was just here a moment ago and hopes to return. Other Senators are in the same situation and other hearings are going on simultaneously with this one. So, we will have members coming and going in the course of the morning.

The testimony we're about to hear today I think will be a very important part of our record. I want to say, Senator D'Amato, this is the tenth hearing that we've conducted on this issue, and we are past the halfway point in hearing from all the witnesses that we think it necessary from which to hear. We will stay on that accelerated schedule until we complete the hearing schedule and then begin the process of drafting a bill for markup.

With that, let me introduce our witnesses today. We will hear first from Mr. Blum, who is the Acting Director of the Congressional Budget Office. Then, in a second panel, we will have two individuals, Mr. William Ferguson from Irving, TX; and Mr. Peter Treadway from Smith Barney, both of whom are industry analysts and outside experts on the issue of the industry, its current circumstances and prospects for the future. Both who will give us their views on how this plan is constructed, and how it would appear to work.

I just have a couple of other comments to make before I yield to my colleague from New York.

Mr. Blum, your testimony today recommends on budget financing of the program saying that it would be faster and cheaper. You claim that the plan's structure does not justify off budget treatment.

This is in quite sharp contrast with Mr. Darman's testimony yesterday in which he recommended against on budget financing because it would be slower and possibly more expensive and because the plan's structure made off budget treatment the proper choice in his view.

So, we are very much interested in hearing the reasoning that would support the CBO position.

Also, there is very considerable concern about the effect of some of the administration's economic assumptions on the cost of the proposal. Yesterday, when we discussed that issue with OMB Director Darman. He, himself, indicated that he's not completely comfortable—my words, not his—with the economic estimates of interest rates and deposit growth and other things. So, we have agreed, based on that, to construct a model that would allow us do some sensitivity testing to see what might be the more appropriate range for the real cost of this package.

We obviously want to try to provide the appropriate amount of money. We don't want to provide too little nor too much, but we don't want to be substantially off to the extent that we can avoid it either way.

I would be very interested in the assumptions on interest rates and deposit growth that CBO has used.

I would like to add something about our other two witnesses, and then we'll call them forward once we finish with Mr. Blum. Mr. William Ferguson, of Ferguson & Company, is a noted thrift analyst. One of the things that we particularly want to hear from him about will be the degree to which a separate, specialized thrift industry serves an important function in our system and whether it can be profitable by focusing in its principal way on the traditional housing role.

Our third witness will be Peter Treadway, of Smith Barney, who is another prominent industry analyst. He will discuss the effects of the plan on capital markets and on the strength of the Federal Home Loan Banks, and the adequacy of the funding and the cost of off budget financing.

So with that, let me yield to my friend and colleague, Senator D'Amato, from New York.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'Amato. Mr. Chairman, let me congratulate you again for moving ahead as expeditiously as you have in these hearings. As you indicated, there are a number of hearings. I have one now that I have to leave for.

I've looked at the testimony of the witnesses. There's one part they all agree on, whether it's off budget or on budget, and that is that it is important to sustain a healthy thrift industry as it relates to providing mortgages for homeownership throughout this country. All of them in their analysis indicate that's important.

I would also make an observation, Mr. Chairman. Not many people pay attention, but with all of the warts and bumps and the hysteria and the crying out about the Southwest plan, at least it was a plan. At least it was operating. And in the talk of the so-called giveaway of taxpayers' money there has never been an opportunity to touch on some of the benefits. The fact that in some of those areas at the present time, actually as a result of some of those arrangements and mergers, there's money being earned for the taxpayer and that as a result of some of the successful operations. There is indeed a partnership. It wasn't just a big giveaway that everybody claims. Congress didn't give the Bank Board enough money. They had to use the tax credits. I have to tell you our hysterical colleagues screaming and yelling so that they can get on television so they can get their face slapped up there to say, "I'm fighting for the taxpayer," in the final analysis what they've done is total inaction—inaction. There's absolutely nothing taking place now except we're piling up record breaking losses. The hemorrhage continues. Bad banks are offering higher CD's. The cost to the taxpayers is going to continue. Nothing is being done.

So we had a group of people who wanted the best deal. He didn't get the deal because maybe he didn't come up with enough money, so he starts screaming and yelling and cries "Foul" and he wants his Congressman or his Senator—and I've had plenty coming to see me. I'll tell you something. We'd better get some money into the pipeline. We'd better get a package passed. We'd better continue to move on closing down those operations that should be closed down either because they're a bunch of crooks or because they're incompetent. We've got a combination of those.

The healthy institutions are suffering. And I'll tell you something. One of these days they're going to take a look at what's taking place as a result of what we've done, the inaction, and just the screaming and yelling. By the way, our people at the FDIC and the regulators, they've exacerbated the situation by coming in and throwing a lot of tar and mud around the place. They aren't doing a damn thing to stop that hemorrhaging.

What's happening? It's getting a lot worse. So I'm going to stop at this point and say whether you agree with off budget or on budget you'd better get to the business of beginning to close down those operations that should be closed. We should stop the demagoguery about whether the taxpayer is going to pay—of course he is. There isn't one guy who's going to come forth with a plan where the taxpaper dosen't pay. Certainly we want to minimize the cost to the taxpayer, but there's just too much demagoguery from the Congress and from others about this thing and not nearly enough action.

But you, Mr. Chairman, are to be commended for pushing these hearings and I hope that we get this bill out as I know you do, and make the kinds of amendments and changes that we feel are necessary. I'm sure that even if it's passed into law and starts operation we're still going to have to come forth with amendments and changes as we learn by experience where some of the problems are. So I commend you and I thank our witnesses and I apologize to them, but I'm going to have to go over to a Treasury and Postal Subcommittee hearing.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator D'Amato. I think I should just add one point before yielding to Senator Bryan, and that is that when the President and his group developed the plan, as part of the plan, as I understand it, they made a decision that in effect to suspend the deal making and, of course, there were some administrative actions taken to allow FDIC to come in and take over the administration of some of the insolvent thrifts which they are doing. I notice that another batch has just been taken over, a much larger group.

So I gather that, for whatever reasons they thought best, that they would suspend the deal making until this legislative package by and large was finished. But that's just a supposition on my part, but that's certainly the appearance.

Senator D'AMATO. I agree with you and I think that at this point in time when we have some of these institutions that are just continuing to bleed the taxpayers, to just blanketly say we're not going to continue—to do the best we can until this package is put together is absolutely going to make it that much more costly to resuscitate this whole industry and its a judgment they've made. I disagree. I think that we should continue prudently to do the best we can. They've got everybody second-guessing the FSLIC, but they're going to second-guess them even when we put this package together.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator D'Amato.

Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman. I, too, am going to have to excuse myself shortly so I'm going to yield my time in the interest of hearing from the witness.

The CHAIRMAN. Very good.

Senator Graham.

Senator GRAHAM. No opening statement.

The CHAIRMAN. Thank you.

Before we start I have a prepared statement from Senator Dixon for insertion in the record.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman I am pleased to be here this morning as the Senate Banking Committee completes another week of its tightly scheduled hearings on the problems of the thrift industry. I look forward to hearing the testimony of the Acting Director of the Congressional Budget Office, James Blum, and of financial analysts, William Ferguson and Peter Treadway. As we review the administration's recaptilization and regulatory reform proposal, it is helpful to the committee to be able to draw upon the expertise of today's witnesses.

Last month on the Senate floor and last week before this committee, I outlined a series of basic principles that I believe any legislative solution must meet. Two of those basic principles are that a resolution of the thrift industry problems must be large enough to solve the problem and that it must minimize the taxpayers' role while maximizing the thrift industry's contribution.

During these committee hearings we have heard various estimates of the size of the thrift problems and the costs of resolving them. In order to craft a solution that does not cause us to revisit this issue 3 or 5 or 10 years from now or to call again upon our taxpayers, we need the best possible estimates and projections and analyses.

I would like to thank our chairman for inviting these budgetary and financial experts and for providing excellent briefings to committee members. We are addressing the administration's legislative proposal expeditiously. In doing so, we need to get the best numbers possible so that we can craft the best solution possible.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Blum, we would like to hear from you at this time.

STATEMENT OF JAMES BLUM, ACTING DIRECTOR, CONGRESSIONAL BUDGET OFFICE, WASHINGTON, DC

Mr. BLUM. Thank you, Mr. Chairman. I am very pleased to be here this morning to discuss the budget and economic implications of the savings and loan problem. I hope that the Congressional Budget Office can be of service to the committee as you deal with this very major and very complex problem.

We have prepared a more lengthy formal statement that I would like to submit for the record and, in essence, just work from the summary that is also part of the statement.

The CHAIRMAN. Without objection.

Mr. BLUM. We shall turn first to the size of the problem. The ultimate cost of the savings and loan problem, as the committee now I'm sure fully recognizes, is very uncertain. Obligations that have a present value cost of about $40 billion already have been made in dealing with nearly 300 insolvent thrifts over the last 3 years. About 350 thrifts are insolvent today and another 150 thrifts are expected to become insolvent in the next year or so. As a matter of fact, if one were to remove the goodwill from their books, which is considered an asset under GAAP accounting standards, they would be judged insolvent today as well.

The administration estimates that the cost of closing these thrifts or merging them into healthy financial institutions would be roughly $44 billion in present value terms. This estimate could be too low for two reasons.

First, the cost could grow if the financial condition of the presently insolvent thrifts continues to deteriorate as it has in recent years. And that goes to the point that Senator D'Amato was just making.

Second, the recent rise in interest rates may also have an adverse impact on the industry. And that goes to your opening remarks, Mr. Chairman.

The administration's plan for dealing with the remaining insolvent thrifts has three main components: first, borrow $50 billion through an off-budget entity to finance near-term resolutions; second, to draw on the resources of the savings and loan industry to the extent possible; and third and most important, provide unlimited Treasury resources to finance the remaining costs.

Regardless of the size of the problem, therefore, the administration's plan would provide sufficient resources to do the job. If costs turn out to be greater than the $44 billion in present value terms, the Treasury will provide the additional resources.

The size of the problem is usually calculated in present value terms. When we look at the budget impact, however, we normally speak about it in cash terms since the budget is a cash-based budget.

We have taken the administration's figures that have been presented to the committee on a number of occasions and most recently yesterday by Mr. Darman, and combined the various estimates into a comprehensive cash flow statement. This is contained in table 1 in the formal statement, immediately following page 5. In addition to rearranging the administration's numbers, we have also filled in some missing pieces.

Looked at in these terms, the administration's plan—again I want to emphasize that we're using their numbers, not ours—calls for spending $205 billion over the 1989 to 1999 period, of which $136 billion would be for resolving cases, administrative expenses, and paying off FSLIC notes.

The CHAIRMAN. Excuse me. Let us try to follow you. Are you going to work off table 1 that you just cited?

Mr. BLUM. That's right. In table 1, the right-hand column is the total for 1989 to 1999. The first figure that I talked about was $136 billion, which is the fourth figure down. This is the money that would be used for case resolutions, administrative expenses, and paying off of the Federal Savings and Loan Insurance notes that have been issued in the last couple of years.

The remaining $69 billion, under the second tier of the figures under the label "Debt Service," would be paid to service the debt that has been incurred in financing this plan. If you add the two figures together, the $136 billion and the $69 billion, the result is $205 billion, which is the total cash to be used under the administration's plan.

The missing piece on that table, just to let you know what piece we added, is essentially the last line under the debt service label, called interest on Treasury borrowing. Now that's a CBO calculation using the administration's interest rate assumptions. It is simply the additional cost of all of the Federal Treasury borrowing that will go on to finance this plan.

The CHAIRMAN. That's the $16 billion that is just above subtotal for debt service?

Mr. BLUM. That's correct.

The CHAIRMAN. And you're saying that, in effect, constitutes the premium cost, as I understand it?

Mr. BLUM. No, no. It is based simply on three entries for the budget that are recognized in the administration's plan. The first entry would be the net positive outlays that FSLIC and the Resolution Trust Corporation would incur over this period. If you look on their budget tables, they do show net positive outlays. Those net positive outlays will have to be financed by the Treasury. Since we're in a deficit situation now, we will have to borrow the money needed. So this is simply figuring out the interest impact of borrowing that money to finance those net outlays by FSLIC.

The second component is the large portion of the interest that the Treasury itself will pay on these $50 billion in bonds to be floated by the Resolution Financing Corporation. That also will have to be financed.

And the third component is the cash cost of these FSLIC notes that the Treasury will have to pick up. They have been recorded in the budget now as outlays, but they haven't been financed. No cash has exchanged hands. The note has simply been extended and recorded as an outlay. In 10 years' time, we have to put cash up to pay for those notes; that's real money that will also have to be borrowed, and we will have to pay interest on that as well.

So all we've done is to recognize these additional Treasury interest costs and bring them onto the ledger. And that's how we've come up with the $205 billion.

The CHAIRMAN. Yes. Senator Graham wanted to ask a question. I think it will be useful for us if we can make sure we're clear in following you.

Mr. BLUM. I think this is vital, by all means.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Mr. Chairman, I'd like to apologize. I'm going to have to leave for about 30 minutes but I will try to return as soon after 11 o'clock as I can.

The CHAIRMAN. Very good.

Senator GRAHAM. If I could ask a couple of questions while I'm here——

The CHAIRMAN. Without objection.

Senator GRAHAM. There were some expenses incurred immediately that is on current fiscal year budget as a result of actions taken at the end of calendar year 1988. We've been given those numbers as being in the range of $11 to $12 billion. Are those incorporated into the numbers that you have here?

Mr. BLUM. Yes, they are incorporated.

Senator GRAHAM. Where would they be incorporated?

Mr. BLUM. They are incorporated partly in the third line under the FSLIC/RTC activity, called "Repayment of FSLIC notes." The part in that line is the cash that will eventually have to be paid in the 10-year period for the notes that were extended in the first quarter of this fiscal year. Another part of it, consisting of cash outlays made in that first quarter, is up above in the case resolution line.

So we have recognized that, as does the administration in their numbers.

Senator GRAHAM. The second question—looking to the future, you cover the period 1989 to 1999. As I understand, the plan is that the bonds which will be issued will be 30-year bonds. Have you done an assessment of what the post-1999 cost of this plan will be?

Mr. BLUM. Well, we haven't extended them in these cash flow terms through that period of time, but we would be happy to do so if that would be useful for the committee.

Senator GRAHAM. If we wanted to assess what the total cost of this proposal will be, it seems to me we need to do so over the total time that is being suggested for its resolution.

Mr. **Blum**. Yes. That clearly can be done in two ways. One is to look at the cash flows literally over the 30-year period. Another way is to convert those into present value terms.

Senator **Graham**. What I'd like to suggest is that we ought to do both. Let's see the total numbers and then what the current value of those total numbers is.

Mr. **Blum**. Fine. We would be happy to do that.

The **Chairman**. Thank you. I appreciate that. We will make that request in behalf of the committee as a whole.

(Insert for page 18 of transcript, testimony before Senate Banking Committee, March 3, 1989)

QUESTION FROM SENATOR GRAHAM:

If we wanted to assess what the total cost of this proposal will be, it seems to me we need to do so over the total time that is being suggested for its resolution. . . . Let's see the total numbers and then what the current value of those numbers is.

ANSWER: By the Administration's estimates, the Bush proposal would provide about $136 billion in cash over the 1989-1999 period for resolving insolvent thrifts. As shown in the following table, financing costs for this spending, including the CBO estimate of the interest on Treasury borrowing, would add another $69 billion to the cost, so that total spending over the next 10 years would reach $205 billion. These costs would total $473 billion by 2021, based on the Administration's estimates. (Financing costs are usually not included in measuring the cost of a federal program, in part because there is no clear-cut way to identify the extent to which any particular program is financed by taxes or borrowing, especially over the long term.)

On a discounted present value basis, the Bush proposal would involve spending an estimated $97 billion on case resolution and administrative costs (measured as of the beginning of fiscal year 1989). Liquidation proceeds would have a present value of about $15 billion, so that net costs would be $82 billion. Close to 70 percent would be financed by the Treasury, with the remainder covered by assessments, Federal Home Loan Bank contributions, and other income.

THE BUSH ADMINISTRATION'S ESTIMATE FOR FSLIC, RTC, REFCORP, AND TREASURY SPENDING, INCLUDING INTEREST ON TREASURY BORROWING (By fiscal year, in billions of dollars)

	Outlays 1989-1999	Outlays 1989-2021	Present Value (Discounted to beginning of 1989)
Case Resolution and Related Costs	136 a/	136	97
Financing Costs			
REFCORP Debt Service	42 b/	121 c/	41
FICO Debt Service	11 b/	32	11
Treasury Borrowing	16 d/	184	32
Total Spending	205	473	181

NOTES: This table is based on the Administration's estimate of expenditures for various items; it does not reflect the economic assumptions of the Congressional Budget Office or any other reestimates. The Administration's estimates do not include any estimates for revenue losses resulting from tax benefits.

The table does not include spending for assistance to thrifts beyond 1999.

FSLIC = Federal Savings and Loan Insurance Corporation; RTC = Resolution Trust Corporation; REFCORP = Resolution Funding Corporation.

a. Does not include $8.8 billion to recapitalize the new savings association insurance fund (SAIF).
b. Includes principal and interest.
c. The Administration estimates that the Treasury will pay $94 billion of this amount.
d. CBO has added the additional interest costs associated with Treasury borrowing, using the Administration's economic assumptions.

Senator BRYAN. Mr. Chairman, if I might suggest, as you'll recall, yesterday Mr. Darman indicated he was going to send over to our staff some computer runs based upon some various assumptions, variation of interest rates, variation of the deposit inflows. If we could have Mr. Blum take a look at some of that to see whether or not they reach the same conclusions in terms of the dollars that were being given in terms of those various assumptions.

The CHAIRMAN. Let me follow up on that for a minute. That very thought has been in my mind. That is, one of the things that was touched on earlier with Mr. Darman was to try to set up a model where we could test the sensitivity of some of the critical economic assumptions, especially the interest rate assumption, which is built into the plan seems very low and really unrealistically low.

We left it that we would work with OMB to try to decide which variables we would test. So, we have commenced and will follow through on those discussions and will figure out precisely what we want them to do in that area because it's a critical part of the puzzle.

Let me ask in relationship to that, how far out do CBO economic assumptions go into the future?

Mr. BLUM. Well, we typically extend them only 5 years into the future, through 1994. We can, for planning purposes, extend them further, but I think we have gone as far as the year 2000.

The CHAIRMAN. When you do that, when you go beyond 1995, do you just lock in the last year's number and carry it forward? Is that the way you do it?

Mr. BLUM. Correct.

The CHAIRMAN. I would wonder if you would be able to plug in what are today the operational CBO assumptions on the critical items like interest rates and growth rates and so forth and see how that alters the numbers. Are you able to do that for us?

Mr. BLUM. Yes, we would be happy to do that.

The CHAIRMAN. I think we ought to have that as well. I think that can be useful to see how CBO baseline assumptions that are a key to this plan and would compare to the administration's assumptions. What I'm really interested in is how much they alter the total numbers in both the total costs and also the timing of the cost. Does it throw it off in terms of when the money is needed and so forth?

(Insert for page 20 of transcript, testimony before Senate Banking Committee, March 3, 1989)

QUESTION FROM SENATOR RIEGLE:

I wonder if you would be able to plug in what are today the operational CBO assumptions on the critical items like interest rates and growth rates and so forth and see how that alters the numbers. . . . What I'm really interested in is how much they alter the total numbers in not just the total costs but also the timing of the costs.

ANSWER: If Congressional Budget Office (CBO) assumptions were used to estimate the cost of the Bush proposal, assuming the Administration's estimate of expenditures for case resolutions, outlays would exceed the Administration's projections by an estimated $8.5 billion over the 1989-1994 period, and by about $34 billion over the 1989-1999 period. These CBO estimates are summarized in the following table. As provided in the legislation, any shortfall in income or increase in expenses would be paid by the Treasury.

The Administration projects that thrift deposits will grow at 7.2 percent annually, and estimates its premium income on that basis. Since May 1988, monthly outflows from thrifts have exceeded deposits. Nonetheless, including interest earned on deposits, aggregate thrift deposits grew by about 4 percent in calendar year 1988. As a result of higher capital standards that the legislation would require, as well as anticipated industry restructuring and reductions in the "thrift premium," CBO expects that deposits in savings institutions would continue to grow at rates below historical levels over the next 10 years--slowing to 2 percent in 1989, with no growth expected in 1990. CBO projects deposit growth of 1 percent in 1991, increasing to 5 percent by 1992, and stabilizing at 6 percent by 1993. On this basis, CBO estimates that premium income over the next 10 years would be $5.5 billion less than projected by the Administration, assuming enactment of the Bush proposal.

Using CBO's interest rates also increases the cost of debt service. On average, CBO interest rates exceed those estimated by the Administration by about 1 percentage point in 1989, 2 percentage points in 1990, and 3 percentage points in 1991. Over the 1989-1999 period, an additional $13.2 billion would be spent, relative to the Administration's estimates, to pay interest on $19.2 billion of promissory notes issued by the Federal Savings and Loan Insurance Corporation (FSLIC), $10.8 billion in Financing Corporation (FICO) bonds, and $50 billion in Resolution Funding Corporation (REFCORP) bonds. In addition, the interest costs associated with Treasury borrowing would increase by $17.6 billion over the next 10 years, if CBO's assumptions are used. These costs would be offset by savings of about $2.5 billion, because higher interest rates reduce the amount of cash needed to purchase zero-coupon Treasury securities that would be used to defease the principal on the FICO and REFCORP bonds.

CBO is not able to evaluate the effect that changes in economic assumptions would have on the level of future insolvencies, nor the costs associated with such insolvencies. While regional, national, and international economic conditions will contribute to the ultimate cost of Administration's proposal, CBO has no basis for translating changes in economic variables into precise cost estimates.

REESTIMATES TO THE BUSH ADMINISTRATION PROPOSAL, USING CBO ASSUMPTIONS ABOUT INTEREST RATES AND DEPOSIT GROWTH RATES (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994	1989-1994	1989-1999
Changes in:								
Assessment Income	0.0	0.2	0.4	0.5	0.6	0.5	2.1	5.5
Debt Service								
Interest on notes	0.0	0.3	0.4	0.5	0.5	0.5	2.3	4.4
Interest on REFCORP bonds	0.0	0.1	0.5	0.9	0.9	0.9	3.4	8.0
Purchase of zero coupons, REFCORP	-0.1	-1.0	-1.3	0.0	0.0	0.0	-2.5	-2.5
FICO financing	0.0	0.1	0.1	0.1	0.1	0.1	0.4	0.8
Interest on Treasury borrowing	0.0	0.0	0.1	0.4	0.9	1.3	2.7	17.6
Total	0.0	-0.4	0.2	2.4	3.0	3.4	8.5	33.9

NOTES: This table is based on the Administration's estimate of expenditures for case resolutions, and administrative and other expenses and does not include any Congressional Budget Office reestimate of these aspects of the proposal.

Details may not add to totals because of rounding.

REFCORP = Resolution Funding Corporation; FICO = Financing Corporation.

Senator GRAHAM. And another item which I think is critical is the allocation of the costs. I believe it's becoming increasingly clear that the taxpayer is the residual payer in this. That is that all of the upside risks get shifted to the taxpayer with the contribution of the industry being within relatively narrow limits a fixed quantity.

Mr. BLUM. That's certainly true.

Senator GRAHAM. And so I'd like to know how those different assumptions then end up affecting what proportion of this—as recently as a National Public Radio broadcast this morning I was still hearing the number that the taxpayers were going to pay $40 billion and the industry would pay $60 billion to resolve this problem. I think that allocation has gotten sort of currency and fixed in people's minds and if we're talking about something substantially different than that, which I think we are, that fact ought to be understood.

Mr. BLUM. I would comment in response to Senator Graham's earlier question about extending the costs beyond the year 1999, that the critical thing that goes on for those 20 years is really the interest on these 30-year bonds and on Treasury and Financing Corporation borrowing. That would be again using the administration's assumptions. It would be a cost of roughly $8 billion a year. So you can just multiply 8 times 20.

Senator GRAHAM. So that's another $160 billion.

The CHAIRMAN. I think the interest rate assumption during that time period may be as low as 4 percent.

Senator BRYAN. In fiscal year 1994 it goes to 4 percent.

The CHAIRMAN. I don't know whether they lock it in at that level and carry it forward, but my hunch would be that they are using a very low financing rate to generate that number. We can check that out.

Mr. BLUM. The rate would be calculated at the time the bonds were floated, so they would be yielding a higher rate of return than the 4 percent. That's just their estimate of interest rates in 1994, for example; but when you actually float the bonds in 1989, 1990 and 1991, they do have higher interest rates.

Senator BRYAN. It's 9.5 percent right now, isn't it? Those were the numbers I saw.

Mr. BLUM. I think it's over 9 percent, yes, sir.

The CHAIRMAN. Can we now take you down through in relationship to Senator Graham's other question the sources of cash on your statement? We stopped you halfway down.

Mr. BLUM. That's a good point. We have established that $205 billion in cash is needed over this 11-year period. The bulk of that money is going to come from borrowing. Looking down at the borrowing line, we have $50 billion to be raised by this new funding corporation that the administration has proposed. Another $7 billion will be coming in from the Financing Corporation (FICO) in 1989 and 1990—that's the financing corporation that was set up two years ago. The remainder will be coming from the Treasury, and that's $84 billion by our calculation.

The other sources provide the remainder of the needed calculation. The assessments on the thrifts paid to FSLIC, REFCORP, and FICO together total about $31 billion over this 11-year period. Liquidation proceeds provide another $22 billion. Parenthetically, I could point out that we've put liquidation proceeds here under income because that's how the administration has done it. Another way of doing it is to net them against the case resolution costs, because that simply is the return that we get when we close a thrift and liquidate its assets. That's the money we get back. So the net cost of liquidation or closing or case resolution could be handled somewhere else.

The other moneys are quite small. The contributions from the Federal Home Loan Banks themselves over this period total $6 billion, and other miscellaneous income is $5 billion.

The CHAIRMAN. So that adds to $64 billion cash in in a sense from industry-related directions.

Mr. BLUM. That's right.

The CHAIRMAN. So, then, when we go to the broad public sector direction, let us go down under the borrowing category and take us through those three if you would.

Mr. BLUM. Well, the $50 billion is the $50 billion in bonds, referring to those bonds that the administration has proposed be raised through this Resolution Financing Corporation. The $7 billion is what remains of the $10.8 billion that was authorized in FICO bonds for this period, in 1989 and 1990. And the remainder is the Treasury. The Treasury is the residual source for all of the money in the administration's plan. We arrive at that figure simply by starting with the $205 billion in cash that is going to be used, and subtracting the money coming in; that's the residual number.

The CHAIRMAN. I'm struck by the fact that that has been a mystery number, the so-called Treasury borrowing, as you've labeled it here, because the focus has tended to be on the $50 billion of the zero coupon bonds. The $84 billion that you've identified is really the money that has to be generated by the Government and spent and to come from the taxpayers. There's an $84 billion gap, if you will, that has to be picked up here.

That indicates to me that when you start looking at relative shares of where money comes from here that that $84 billion out of a subtotal of the amount that has to be borrowed of $141 billion, it's certainly the biggest share and it's certainly well more than half.

I take it that you're also testifying today that if economic assumptions work against us and the costs go up, one presumes that the area where the higher cost would be financed is in that category. In other words, at the Treasury because it's the deep pocket of last resort.

That's one of the reasons why, I think we've got to have a good sense for what is most likely to happen. Because if we were to find out, for example, that that figure is $20 billion higher over the 11-year period or more, I think we need to try to understand that now rather than wake up one morning and find that we've lowballed the need and we've got a much larger financing requirement on our hands.

Does that logic follow in your mind?

Mr. BLUM. Absolutely.

The CHAIRMAN. Well, why don't I let you now continue from that point.

Mr. BLUM. All right. Let me turn to the issue that you raised, Mr. Chairman, in your opening remarks with respect to the budgetary treatment, on-budget or off-budget. As you said, the administration is proposing an off-budget solution for raising this $50 billion from the private credit markets, to avoid adding to the budget deficit problem. It does this by creating a separate Resolution Financing Corporation modeled precisely after the financing corporation, FICO, that was created 2 years ago. But obviously some concern has been expressed about this feature of the administration's plan.

Now CBO believes that the basic thrust of the proposal to avoid budget deficit impact actually makes sense, because spending this $50 billion in borrowed funds would have virtually no macroeconomic impact. It does not have any impact on private consumption or saving and will not affect the economy in any material way. That was pointed out, for example, in a piece by Martin Feldstein in the Wall Street Journal on Wednesday on the editorial page. I don't know if you've already made that part of the record——

The CHAIRMAN. Yes, we have.

Mr. BLUM. I would recommend that you do so.

The CHAIRMAN. We'll do that right now.

[See page 571, Part III.]

Mr. BLUM. Actually, we would agree with that analysis completely. Furthermore, there's another analysis that I think is also very good and that I bring to the committee's attention. This is an excellent report that was done by the Congressional Research Service in January entitled, "FSLIC, the Budget, and the Economy" by G. Thomas Woodward. It makes exactly the same point: that there is no macroeconomic impact if we're borrowing the money from the markets and then essentially returning it again to the markets in the form of savings and loan deposits.

So in that sense, we would agree with the administration that it should not add to our deficit problems that we're facing in the current year.

Nevertheless, we would prefer to have the spending of this money included in the budget. We believe that a good case can be made, however, for excluding that spending from the Balanced Budget Act calculations in exactly the same manner as asset sales and loan prepayments are now excluded under the Balanced Budget Act calculations.

In essence, the borrowing and spending of this $50 billion is the flipside of these asset sales that we now fully recognize do not really reduce the deficit problem. In the same manner, the spending of this money is not going to add to the deficit in an economic sense.

Now this treatment would permit less costly Treasury financing and quicker action than setting up a new off-budget funding agency. It always takes time to set up something that's new and off-budget and float a certificate that's new and strange to the markets. They are very much familiar with Treasury bonds, obviously. This would also permit Treasury to use whatever distribution of notes that it wants to finance this borrowing over time, and there would be no extra premium as there would be on special bonds floated by an unfamiliar, off-budget entity. And I gather that later this morning you're going to hear from witnesses who can testify on how large that premium might be.

Excluding spending from the Balanced Budget Act calculations, we recognize, may set unfortunate precedents; but I would maintain that creating off-budget entities to perform essentially Government functions does so as well.

In any event, we believe that REFCORP is not truly an off-budget entity as we read the administration's proposal; and we think that unless other provisions were put in the bill, it should be included in the budget.

The appropriate budgetary treatment for financing a solution to this problem, however, is ultimately a policy matter that should be settled by the Congress and the President rather than by the staffs of CBO or the Office of Management and Budget.

The last point in the testimony looks ahead to the other basic ingredient of the administration's plan, that of regulatory reform. In addition to acting quickly to close or merge insolvent thrifts, it is very important to create a regulatory system and a deposit insurance system that will prevent future problems from developing.

The key ingredients are, we believe, higher capital requirements, stronger control and oversight, and the ability to take appropriate action as thrifts become insolvent.

Now the administration's proposal for reform does include these ingredients and appears to be a step in the right direction.

A substantial portion of the currently solvent thrifts will have difficulty, however, in meeting the new capital standard. The probable effect of the proposed higher capital requirements will be to reduce the size of the savings and loan industry; but it will also be put on a much sounder financial footing, and the surviving thrifts, along with other institutions such as banks and insurance companies, should be able to serve more effectively the needs of home owners and consumers in the future. And I dare say that solving this problem will also enable interest rates that are charged on deposits to be much lower.

That concludes my formal statement, Mr. Chairman.

[The complete prepared statement of James L. Blum follows:]

Statement of
James L. Blum
Acting Director
Congressional Budget Office

before the
Committee on Banking, Housing, and
Urban Affairs
United States Senate

March 3, 1989

NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EST), Friday, March 3, 1989.

Mr. Chairman, I am pleased to appear before this Committee to discuss the financial difficulties of the savings and loan industry, and the budget and policy implications of providing federal assistance to resolve those difficulties. My testimony today focuses on the following major areas:

- The size of the problem;
- The impact of the Bush Administration's proposal on the budget;
- The use of an off-budget entity to finance a resolution; and
- The effect of regulatory reform on the thrift industry.

THE SIZE OF THE PROBLEM

Although the Federal Savings and Loan Insurance Corporation (FSLIC) dealt with more than 200 bankrupt thrifts in 1988, the crisis is far from resolved. About 350 insolvent thrifts still remain open, and many solvent thrifts are financially weak. Because FSLIC itself is insolvent, it has resorted to a variety of creative financing methods in dealing with many of the thrifts acquired with FSLIC assistance, and in the process, it has committed its premium income for many years to come. FSLIC has also left open many questions about both the final cost and the survival of some of the thrifts acquired with government assistance.

To resolve an insolvent thrift, the government must eliminate the gap between the institution's liabilities and its assets. In other words, the government must ensure that assets earning sufficient returns back insured deposits. The ultimate cost of resolving the thrift crisis, therefore, will be roughly equal to the combined negative net worth--the difference between the market value of assets and liabilities--of all insolvent thrifts when each thrift is resolved. The longer the delay in resolving the problem, the more the net worth of the remaining insolvent thrifts deteriorates.

The government's remaining obligations fall into three categories: commitments made in resolving previously insolvent thrifts, dealing with currently and prospectively insolvent thrifts, and restoring the reserves of the deposit insurance fund. Under the Administration's proposal, $8.8 billion will be used over the next 10 years to replenish the insurance fund. The ultimate cost of the other components of the President's plans are extremely uncertain.

In dealing with the vast majority of thrifts that have already been resolved, FSLIC provided financial assistance to the acquirer of the insolvent thrift. As a result of these transactions, the Administration estimates that FSLIC has made commitments having a present value of about $40 billion. These commitments depend on a variety of factors, including future interest rates and the prices at which various assets are sold. As a result, there is considerable uncertainty about what the ultimate cost of these outstanding commitments will be.

How much it will cost to resolve the currently and prospectively insolvent institutions is even more uncertain. Although the final cost depends on the difference between the market value of the assets and liabilities of insolvent thrifts, there is only a limited basis for determining this difference. While thrifts report the book values of their assets and liabilities, these values are largely based on historic costs, and may have little relation to what they are currently worth. The Bush

Administration estimates that the present value cost of resolving the currently and prospectively insolvent thrifts will be $44 billion, which is several times larger than the book value of their negative net worth. This amount includes the cost of dealing with the 351 thrifts that are presently insolvent as well as the 152 thrifts that would be insolvent if goodwill--an asset that is generally created by the acquisition of another thrift--were excluded.

A number of other estimates have been made as to the total cost of ultimately resolving the thrift crisis. For the most part, they entail a present value cost of at least $100 billion. While the Administration is essentially estimating that the total cost will be around $100 billion, it could be understating the ultimate cost of resolving the existing insolvent thrifts.

In the first place, most of the estimates, as does the Administration's, essentially assume that the thrifts are resolved instantaneously. In all likelihood, however, it will take substantial time before all these insolvent thrifts are liquidated or acquired with financial assistance. Yet, the net worth of insolvent thrifts, measured by book value, has shown a strong tendency to decline over time. In fact, the negative net worth of the 351 firms that are now insolvent by Generally Accepted Accounting Principles (GAAP) more than doubled in each of the previous two years (see Figure). To the extent that this trend continues and the market values mirror it, the ultimate cost would be significantly higher. For example, assume the government can administratively spend at most $25 billion in any year (one-half for liquidations), which is actually the amount the Administration estimates it will spend in 1990. Also assume that the market value of the net worth of insolvent thrifts declines by 15 percent per year, which is much slower than the historic decline in the book value of their net worth. Under these assumptions, at the end of 1991 the government would still expect to spend over $15 billion to resolve the remaining thrifts. One of the noteworthy features of the Administration's proposal is that it attempts to restrict lending activities of insolvent institutions to limit this deterioration. Their efforts, however, may not be completely successful.

Another reason that the problem may ultimately be larger than what the Administration estimates is that short-term interest rates have increased significantly since the period on which the last estimates are based, which is the third quarter of 1988. Since assets of thrifts tend to have longer maturities than their liabilities, higher interest rates will increase the size of the problem. The cost of funds for thrifts will increase more rapidly than their return on assets--that is, their profit margins will contract. Thus, the recent rise in interest rates may not only increase the number of firms that become insolvent, but it may very well increase the cost of resolving those thrifts that already have become insolvent.

ESTIMATING THE IMPACT OF THE BUSH ADMINISTRATION'S PROPOSAL ON THE BUDGET

Based on the Administration's financial projections for the 1989-1999 period, the Congressional Budget Office (CBO) has analyzed the Administration's plan and its projected budgetary impact. The three major features of the plan are:

- Borrow $50 billion through an off-budget entity to finance near-term resolution costs;

- Draw on thrift industry resources to the extent possible; and
- Provide unlimited Treasury resources to finance the remaining costs.

Overall, most of the costs of the plan will be paid by the Treasury.

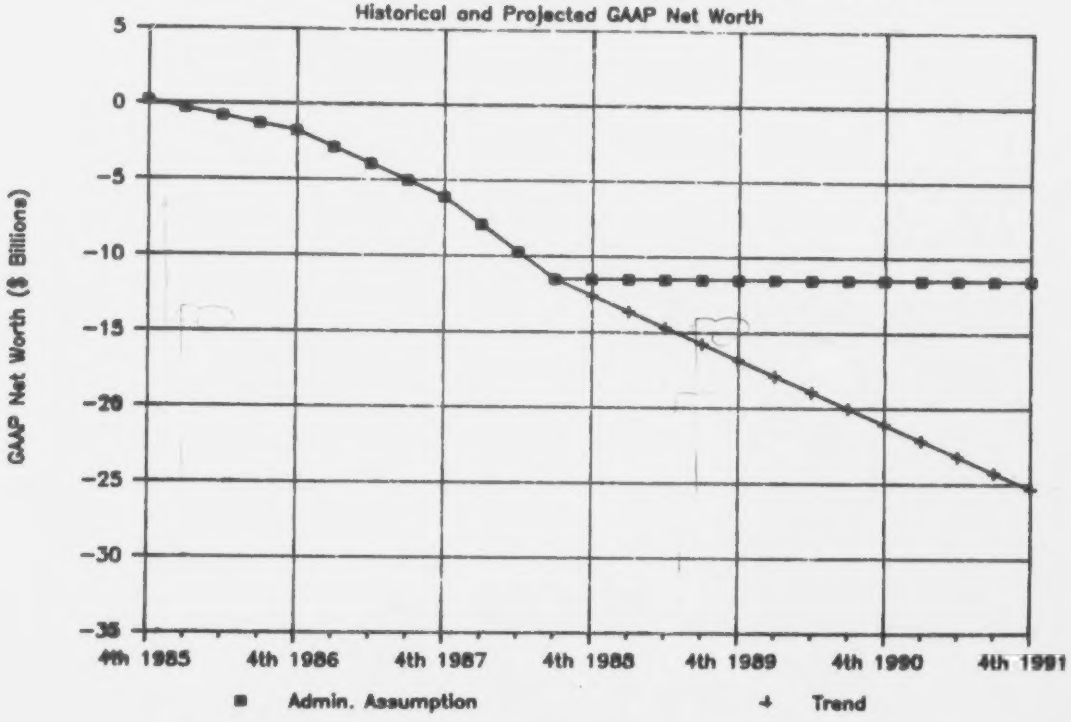
Paying for the Plan

By the Administration's estimates, the plan would provide about $136 billion in cash over the 1989-1999 period for use by FSLIC and the new Resolution Trust Corporation (RTC), which would resolve the insolvent thrifts insured by FSLIC. Of this $136 billion, $117 billion would go for case resolution costs, administrative expenses, and interest on existing FSLIC/RTC obligations; and $19 billion would be used to pay off outstanding FSLIC notes (see Table 1). Under Administration assumptions, another $69 billion would be spent over the 1989-1999 period to service the various forms of debt used to finance the plan: $42 billion to cover principal and interest on bonds issued by the new Resolution Financing Corporation (REFCORP), $11 billion to cover principal and interest on bonds issued by the existing Financing Corporation (FICO), and $16 billion for interest on additional Treasury borrowing. (The latter costs are not specifically addressed in the Administration's projections.) Interest costs would continue for many years beyond 1999, starting at about $8 billion in the year 2000.

President Bush's proposal also provides added revenues by increasing the fees that both banks and thrifts pay for deposit insurance, though these increases would

FIGURE

351 Unresolved Insolvent Thrifts



SOURCE: Congressional Budget Office using Federal Home Loan Bank Board data.

NOTE: The trend line assumes the average historical rate from 1985 to 1988.

TABLE 1. ESTIMATED USES AND SOURCES OF CASH UNDER THE ADMINISTRATION'S PLAN (By fiscal years, in billions of dollars)

	1989-1994	1995-1999	TOTAL 1989-1999
USES OF CASH			
FSLIC/RTC Activity:			
Case resolutions	85	19	105
Administrative expenses and interest on FSLIC obligations	8	4	12
Repayment of FSLIC notes	2	17	19
SUBTOTAL: FSLIC/RTC ACTIVITY	95	40	136
Debt Service:			
Interest on REFCORP bonds	17	19	36
Purchase of REFCORP zero coupon bonds	6	0	6
Debt service on FICO bonds	6	5	11
Interest on Treasury borrowing	5	11	16
SUBTOTAL FOR DEBT SERVICE	34	35	69
TOTAL USES	129	75	205
SOURCES OF CASH			
Income:			
Assessments on thrifts by FSLIC, REFCORP, and FICO	15	16	31
Liquidation proceeds	18	4	22
Contributions by FHLBs	4	2	6
Miscellaneous income	3	2	5
SUBTOTAL: INCOME	40	23	64
Borrowing:			
REFCORP bonds	50	0	50
FICO bonds	7	0	7
Treasury borrowing	32	52	84
SUBTOTAL FOR BORROWING	89	52	141
TOTAL SOURCES	129	75	205

SOURCE: Congressional Budget Office, based on Administration projections.

NOTES: This table includes the aspects of the Administration's plan involving the savings and loan industry. The effects of increasing FDIC assessments on commercial banks are therefore not reflected in the table.

The figures in the table represent Administration estimates, except for the interest on Treasury borrowing, which was projected by CBO using the Administration's economic assumptions.

contribute little to the cost of resolving the crisis. The Administration estimates that the increase in the Federal Deposit Insurance Corporation (FDIC) fee on commercial banks would generate $7.9 billion over the 1990-1994 period and another $12 billion in the following five years to bolster FDIC reserves. These receipts would reduce the budget deficit, but would not provide resources for resolving thrifts and are not included in Table 1. The proposed assessments on thrifts would increase receipts by only $0.4 billion through 1994, and would result in less income thereafter.

Over the 1989-1999 period, sources other than borrowing will account for receipts of about $64 billion, compared with disbursements of about $205 billion. During this period, the only sources of funds, other than borrowing, are about $31 billion in assessments paid by savings and loans (including assessments paid to REFCORP and FICO), $22 billion in liquidation proceeds, $6 billion from the retained earnings of the Federal Home Loan Banks (FHLBs), and $5 billion in miscellaneous income.

The Administration proposes to bridge this gap with a mixture of on- and off-budget borrowing. REFCORP--intended to be an off-budget entity--would borrow a total of $50 billion in fiscal years 1989, 1990, and 1991. FICO borrowing would provide $7 billion, and CBO estimates that Treasury borrowing would fund the remaining $84 billion.

The principal on the REFCORP bonds would be repaid by purchasing U.S. Treasury zero coupon bonds that, on maturity, would be worth $50 billion. The interest payments account for almost all of the cost of servicing this debt. While these interest expenses would be partly paid from FSLIC receipts and Federal Home Loan Bank retained earnings, they would be paid mostly out of the general funds of the Treasury. By the Administration's estimates, Treasury would cover $6 billion of the $17 billion in interest due in the 1989-1994 period, and at least $16 billion of the $19 billion to be paid in each five-year period thereafter.

Including its portion of the interest on the REFCORP bonds, the Treasury would provide about $27 billion to FSLIC, RTC, and REFCORP from 1989 to 1994. Another $41 billion would come from the Treasury in the following five years to pay off previously issued notes ($17 billion), pay REFCORP interest ($16 billion), and cover other cash needs. Interest on the increase in its own borrowings would add another $16 billion to Treasury's costs over the 1989-1999 period.

Interest costs on borrowing would continue to be paid after 1999. Most or all would be paid by the Treasury and would add to the deficit in each year. Over the entire life of the plan, the Treasury would account for more than 70 percent of the resources used to finance the Administration's program.

Budgetary Impact of the Plan

The Administration's proposal, like the existing FICO arrangement, is structured to minimize the budgetary impact in the initial years. It would accomplish this by treating REFCORP as off-budget and by recording the $50 billion in payments by REFCORP to the new Resolution Trust Corporation as offsetting collections on the budget. As shown in Table 2, this treatment would result in large collections offsetting heavy spending in 1989, 1990, and 1991. Disbursements by FSLIC and RTC would total over $84 billion in that three-year period, but the budget would record only $18 billion as budget outlays, mostly in 1989.

The Bush Administration's plan, scored in this way, would result in lower outlays than the Reagan budget over the 1989-1994 period. Although 1989 outlays would be increased by $2.4 billion, they would be reduced by a total of $5.0 billion over the next five years (see Table 3). This reduction in outlays stems, in part, from the increase in the FDIC assessment, which the Administration estimates would bring in close to $8 billion over the five-year period. The Bush Administration's proposal, excluding the change in FDIC assessments, would increase net budget outlays by $0.7 billion in 1990, and by $5.5 billion over the 1990-1994 period.

The effect of the Administration's plan on the budget is very uncertain, since many components are difficult to predict. I have already discussed the significant uncertainty that surrounds estimates of the cost of resolving currently and prospective insolvent thrifts. Interest costs and assessment income are also uncertain. To the extent that the costs are greater or the income is lower than the Administration projects, expenditures funded by the Treasury and the deficit would both be higher.

CBO's economic assumptions, for example, include interest rates significantly above those used by the Administration in estimating the impact of its proposal. On 30-year government bonds, CBO assumes rates averaging about 200 basis points higher in calendar year 1990 and close to 300 basis points higher in 1991 than the

TABLE 2. THE BUSH ADMINISTRATION'S PROJECTIONS FOR FSLIC/RTC AND TREASURY NET OUTLAYS, Assuming REFCORP Borrowing Off-Budget (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994	1989-1994	1989-1999
FSLIC/RTC Disbursements[a]	27.7	31.7	24.3	10.4	11.0	8.2	113.2	138.2
FSLIC/RTC Collections								
Proceeds from REFCORP	-10.0	-25.0	-15.0	0.0	0.0	0.0	-50.0	-50.0
Other[b]	-7.0	-5.3	-3.3	-5.8	-6.3	-5.9	-33.5	-50.3
TOTAL COLLECTIONS	-17.0	-30.3	-18.3	-5.8	-6.3	-5.9	-83.5	-100.3
FSLIC/RTC Budget Outlays	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Treasury Payments for REFCORP Interest	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0

SOURCE: Office of Management and Budget.

NOTE: This table assumes that REFCORP is off-budget and that its payments to RTC are treated as offsetting collections as proposed by the Administration. The table is based on Administration projections of expenditures and receipts for the various items; it does not reflect CBO economic assumptions or any other possible reestimates. The Administration's figures also do not include any estimates for revenue losses resulting from tax benefits or additional interest costs associated with Treasury borrowing.

a. Disbursements include payments for old and new cases, as well as use of assessment income to pay interest on REFCORP bonds.

b. Other collections include proceeds from FICO borrowing, plus income from old and new liquidations as well as remaining assessment income.

Administration's. If the CBO assumptions were used instead of the Administration's, interest costs for the REFCORP bonds would be $8 billion higher than the Administration's estimate over the 1989-1999 period. Interest on added Treasury borrowings would be $29 billion through 1999, rather than $16 billion using Administration rates. On the other hand, the amount needed to be invested in zero coupon bonds to cover the principal on the REFCORP bonds would be less than $4 billion rather than the $6 billion projected under lower interest rates.

Assessment income is also very uncertain, because the plan itself--and particularly its regulatory changes--may significantly change the relative size of the industry, as depositors shift to other types of institutions or investments. The Administration's projections assume that thrift deposits will grow by 7.2 percent annually, which represents the average growth from 1983 to 1988. If total insured deposits were to grow at 4 percent a year, FSLIC assessment income over the 1989-1999 period would be $4 billion below the Administration's estimate. If they were not to grow at all, FSLIC assessment income would fall $10 billion below the Administration's projections through 1999. Any such shortfall in funds for thrift resolutions would have to be made up with Treasury funds. The net impact on the deficit, however, would be much smaller. A corresponding increase in deposits at banks would take place, and this rise would result in an increase in assessments paid to the FDIC. Under the Administration's proposal, however, FDIC resources would not be used to resolve thrifts.

TABLE 3 BUDGETARY IMPACT OF THE BUSH PROPOSAL COMPARED WITH THE REAGAN BUDGET, Assuming REFCORP Borrowing Off-Budget (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994	1989-1994
Outlays for Deposit Insurance, Reagan Budget							
FSLIC/RTC	8.7	2.1	6.6	4.9	4.9	3.4	30.6
FDIC	3.8	-1.3	-1.9	-2.6	-2.6	-2.7	-7.3
Total Outlays	12.5	0.8	4.7	2.3	2.3	0.7	23.3
Changes Resulting from Bush Proposal							
Net Outlays of FSLIC/RTC	2.0	-0.7	-0.6	-0.3	-0.2	-1.1	-0.9
Additional FDIC collections	0.0	-0.8	-1.6	-1.7	-1.8	-1.9	-7.9
Treasury interest to REFCORP	0.5	1.4	1.6	0.9	0.8	1.1	6.3
Change in Outlays	2.4	-0.2	-0.6	-1.1	-1.2	-1.9	-2.5
TOTAL OUTLAYS: BUSH PROPOSAL	14.9	0.6	4.1	1.2	1.1	-1.2	20.8

SOURCE: Office of Management and Budget.

NOTE: This table assumes that REFCORP is off-budget and that its payments to RTC are treated as offsetting collections as proposed by the Administration. The table is based on Administration projections of expenditures and receipts for the various items; it does not reflect CBO economic assumptions or any other possible reestimates. The Administration's figures also do not include any estimates for revenue losses resulting from tax benefits or additional interest costs associated with Treasury borrowing.

FINANCING A RESOLUTION BY USING AN OFF-BUDGET AGENCY

Funding the rescue primarily through debt is desirable. Given the need for obtaining large amounts of funds quickly, raising the full amount through large temporary increases in taxes might generate substantial adjustments in private expenditures and could lead to sharp changes in economic activity. Relying on debt financing does not pose such problems.

In fact, issuing debt to resolve insolvent thrifts should not have a significantly adverse effect on the economy. Any increase in interest rates because of the increased supply of bonds should be temporary and not large. The rescue funds would most likely be used to purchase income-yielding assets such as government bonds, mortgages, and other types of assets; this use of the rescue funds should offset any initial rate increase. In addition, a relative decline in rates on bank and thrift deposits should hold down interest rates. Since insolvent thrifts would no longer need to offer premium rates to attract ever-increasing deposits to fund their losses, the remaining thrifts could lower what they have to pay depositors.

Although financing the rescue plan with borrowing seems desirable, such a solution would inevitably raise the structural budget deficit; interest on Treasury or agency bonds will have to be paid. Financing such interest payments with additional debt would cause the cost of the overall rescue to grow at a compounded rate, and would raise an already large structural deficit. The only way to avoid such an outcome is to impose new taxes or fees or to reduce spending. The Administration's proposal does not identify the revenue sources or cuts in spending on other programs

to cover the interest expense of the added debt. The only revenues generated by the proposal--the added insurance premiums paid by the banks and thrifts, additional liquidation proceeds, and contributions from Federal Home Loan Banks retained earnings--are far less than the added debt service costs.

The source of the borrowing is another issue raised by the Administration's proposal. Under the plan, a government-sponsored enterprise, REFCORP, would raise funds for resolving the crisis. Because REFCORP's payments to RTC directly offset agency spending, there is no effect on the budget deficit. The primary reason for this arrangement would seem to be to reduce the budgetary impact of the proposal so as to avoid any consequences of the Balanced Budget Act's deficit targets.

One can make a good case that spending on the FSLIC rescue can be distinguished from most government spending and thus should be exempt under the Balanced Budget Act. Outlays to pay the debt are not likely to reduce private investment by diverting private saving to consumption. These funds would probably be returned to the lending stream. Under such circumstances, reducing spending in other programs or raising taxes because outlays to resolve the thrift crisis breached the deficit targets would constitute a much greater contraction than the Balanced Budget Act envisioned.

Excluding the expenditures for resolving thrifts from the deficit calculations in the Balanced Budget Act would be consistent with the treatment of asset sales under the act. In resolving the thrift crisis, the Administration would be making the

TABLE 4. ALTERNATIVE BUDGETARY TREATMENT OF THE BUSH PROPOSAL, Assuming REFCORP Borrowing On-Budget
(By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994	1989-1994	1989-1999
FSLIC/RTC Disbursements[a]	27.7	31.7	24.3	10.7	11.3	8.5	114.2	140.6
FSLIC/RTC Collections[b]	-7.8	-8.1	-5.8	-6.1	-6.6	-6.2	-40.6	-58.8
FSLIC/RTC Net Outlays	19.9	23.6	18.5	4.6	4.7	2.3	73.6	81.8
Treasury Payments for REFCORP Interest[c]	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0

SOURCE: Congressional Budget Office.

NOTE: The table is based on Administration projections of expenditures and receipts for the various items; it does not reflect CBO economic assumptions or any other possible reestimates.

a. Disbursements include payments for old and new cases, as well as use of assessment and FHLB income to pay interest on REFCORP bonds.

b. Collections include proceeds from FICO borrowing, income from liquidations, assessment income (excluding FICO), and payments from retained earnings of the FHLBs.

c. This category does not include interest on $68 billion in Treasury borrowings through 1999 needed to finance the Administration's proposal. Additional Treasury interest costs would total about $5 billion from 1989 through 1994, and about $11 billion during the next five-year period, under the Administration's economic assumptions. The Administration's figures also do not include any estimates for any revenue losses to the Treasury resulting from tax benefits.

implicit liabilities of RTC into an explicit liability of the government--that is, it would be exchanging one liability for another. Thus, the proposed borrowing would be similar to asset sales by the government; such sales involve the exchange of one asset for another--cash. Asset sales are generally not counted toward deficit reduction targets under the Balanced Budget Act.

This argument does not apply to the interest expense that results from the debt issued to finance the rescue plan. Accordingly, CBO does not believe the interest payments should be excluded from the Balanced Budget Act targets. The Administration's proposal includes these interest payments both in the budget and in computing the budget deficit under the Balanced Budget Act.

In addition, keeping the financing on-budget has some sound economic reasons behind it. To begin with, it would be less costly if it is done by the Treasury. Interest on REFCORP borrowing would exceed a comparable amount of Treasury borrowing by $100 million to $200 million a year. Moreover, using Treasury financing should permit the government to move more quickly to resolve the problem. Establishing a separate financing corporation and a secondary market for its securities could be a time-consuming process. Given the need to resolve the remaining insolvent thrifts quickly, the cost of those delays as a result of issuing bonds through REFCORP could be substantial.

Even if the Congress established REFCORP, it should be included in the budget, and the proceeds from its borrowing should not be considered an offsetting collection (see Table 4 for the budgetary impact of using this treatment). The main reason for counting REFCORP on budget is that it does not appear to be a privately-owned entity. REFCORP would be created by the government for the sole purpose of borrowing funds and transferring them to a federal agency--RTC. REFCORP actions would be controlled by "regulations, orders, and directions" prescribed by the RTC Oversight Board, which would consist of three federal officials. It could not pay dividends to or otherwise benefit its nominal owners, the Federal Home Loan Banks. The bill would also give REFCORP the authority to levy and collect assessments on federally-insured thrifts, functions normally reserved for government agencies. In any case, the Treasury and not these assessments would finance the bulk of REFCORP's borrowing.

Moreover, REFCORP would resemble the Farm Credit System Financial Assistance Corporation (FAC), which was chartered in 1987 to finance assistance to insolvent member institutions of the Farm Credit System. The similarities are striking: the Treasury is obligated to make payments to FAC equal to some or all of the interest payments on its debt for 10 years; FAC exists to finance spending that otherwise would be financed by a federal agency; and it is controlled by federal officials. President Reagan's fiscal year 1990 budget included FAC in the budget as a federal agency. CBO agrees with this scoring, which is consistent with how CBO would score the proposed REFCORP.

Ultimately, the appropriate budgetary treatment for financing a solution to the savings and loan problem is a policy matter. Almost any arrangement sets precedents that could affect future efforts to limit budget deficits. As such, it is a matter to be decided by the Congress and the President rather than by the staffs at

CBO or the Office of Management and Budget. Any legislation that provides additional resources to FSLIC should explicitly stipulate the budgetary treatment of any debt financing used in an assistance plan.

THE EFFECTS OF REGULATORY REFORM

My previous discussion has largely centered on how to pay for the losses that have already occurred because of the thrift crisis. Great importance should also be attached to creating a regulatory system and a deposit insurance system that prevents future crises from developing.

A successful solution to the thrift crisis would enhance the profitability and the survival of healthy thrifts. Most notably, a rapid resolution should substantially benefit the remaining institutions, because the remaining thrifts should experience a significant decline in their cost of funds. On the other hand, much of this benefit might be lost if the surviving thrifts had to pay a large share of the resolution costs.

The long-term prospects of the thrift industry also depend on regulatory reform. Federal deposit insurance reduces the incentive of poorly financed financial institutions to behave prudently. It is necessary, therefore, to establish a regulatory system that both changes these incentives and enables the government to monitor the industry more closely. In fact, the Bush Administration has proposed a significant overhaul of the existing regulatory apparatus. It recommends putting much of the regulatory responsibilities for thrifts in the Department of Treasury and the responsibility for insuring thrift deposits with a newly created Savings Association Insurance Fund.

More fundamentally, the Administration proposes that, in certain critical respects, thrifts be treated more like banks. Specifically, it recommends requiring that thrifts increase their amount of capital. Capital, which is the difference between a firm's assets and its liabilities, is essentially the owners' stake in the firm. Increasing the amount of capital that thrifts must maintain reduces the incentives to make overly risky investments. It also provides a cushion for the insurer in case the institution experiences financial difficulty. Accordingly, the Bush Administration proposes that by 1991 thrifts must--as banks do now--maintain capital of not less than 6 percent of their assets, with one important distinction: the Administration's proposal allows the thrifts to continue to include goodwill as capital, while banks cannot. Thrifts, however, must write off this goodwill over a 10-year period.

A substantial number of thrifts will probably not be able to raise the necessary capital by 1991. Some solvent thrifts have not been profitable, and others have only barely been so. Based on 1988 third quarter data, less than half of the industry met the standard. However, 379 thrifts had GAAP capital between zero and 3 percent of assets. These thrifts would need an additional $14 billion-- about four times their current capital--to reach the 1991 standard (see Table 5). But these thrifts had net losses on income of about $200 million in 1987 and $646 million in the first three quarters of 1988. Therefore, the ability of those thrifts to generate anywhere near the necessary capital through retained earnings is highly questionable. The 972 thrifts whose GAAP capital was between 3 percent and 6 percent of assets are

somewhat better off, but would still face a challenging task. They had net incomes of $2.8 billion in 1987, and $1.5 billion in the first three quarters of 1988, but would need an additional $12 billion of capital. Even if these thrifts were able to meet the 6 percent standard by 1991, many would still have to increase their capital in future years to compensate for their declining goodwill.

The Administration's proposal to raise insurance premiums on deposits at thrifts for a three-year period beginning in 1991 should not pose a significant obstacle to meeting the higher standard. These extra premiums, while still higher than the historically high levels presently in place, are small relative to the capital these institutions require. They would reduce pre-tax income by about $45 million annually for those thrifts whose GAAP net worth is between zero percent and 3 percent of assets, by about $100 million for thrifts between 3 percent and 6 percent, and by about $55 million for those above 6 percent. Moreover, the increase in premiums takes effect in the beginning of 1991, while the higher capital standard takes effect in June of that year.

Although the proposed increase in premiums is not very large, I believe it noteworthy that the Administration proposes to perpetuate a significant difference in the premiums that thrifts and commercial banks pay for federal deposit insurance. To the extent that there is a differential, it should reflect the difference in the likelihood of future defaults between the two institutions. Otherwise, it would place one type of institution at a competitive disadvantage to the other. For example, while thrifts will soon have to maintain the same levels of capital as banks, thrifts have more discretion in acquiring assets. This greater discretion may increase the likelihood of default and justify a higher premium. On the other hand, higher capital standards should reduce the probability of default by thrifts. It would be preferable if such differences in premiums were actuarily based and did not simply reflect the historic experience of the different types of institutions.

While much of the industry may have difficulty generating the added capital internally, it may also have difficulty attracting more equity capital from investors. These institutions may not have sufficiently bright earning prospects to attract additional investments. Therefore, the industry will most likely have to meet the standard through a series of mergers, contractions, and liquidations. Other financial institutions may find undercapitalized thrifts to be attractive acquisition targets. Firms that have excess capital may be able to work out favorable terms for acquiring firms with insufficient capital. Alternatively, by shrinking its size, a thrift reduces its assets and liabilities by the same amount and thereby increases its capital-asset ratio.

The Administration and the Congress will have to take significant steps if they hope to ensure that the higher capital standard is met. The regulatory agency must have the resources and the authority to take firm action for those institutions that do not meet the higher standard. To assure the most efficient consolidation, existing banks and thrifts could be given substantial discretion to acquire thinly capitalized thrifts. There could, for example, be no prohibition against banks acquiring thrifts and no preference given to institutions of a particular state in any given merger or acquisition.

TABLE 5. ADDITIONAL CAPITAL NEEDED TO MEET PROPOSED CAPITAL STANDARDS (In billions of dollars)

Current Capital as a Percent of Assets (GAAP Basis)	Number of Thrifts	Current Assets a/ (1)	Current Capital b/ (2)	Current Ratio (3) = (2)/(1)	Required Capital (4)	Additional Capital Needed (5) = (4)-(3)	Additional Capital as a Percent of Current Assets
0 to 3	379	280.6	3.5	1.2	17.7	14.2	5.1
3 to 6	972	627.9	26.3	4.2	38.4	12.2	1.9
0 to 6	1,351	908.5	29.7	3.3	56.1	26.4	2.9
6 or Greater	1,239	317.5	26.3	8.3	18.6	b/	c/

SOURCE: Congressional Budget Office using Federal Home Loan Bank data.

NOTE: Data for third quarter 1988.

a. Assumes 20 percent of goodwill is reduced from assets and capital to account for partial exclusion of goodwill.

b. Has excess capital of $7.7 billion.

c. Has excess capital that is 44 percent of required capital.

The higher capital standard and more vigilant regulatory surveillance will likely lead to a reduction in both the number of thrifts and the relative size of the thrift industry. The financial difficulty of such a large number of firms, coupled with the lack of capital in the industry, suggests that the industry may benefit from such a contraction. In any case, thrifts compete with banks, mutual funds, insurance companies, and other financial intermediaries. These other institutions, along with the surviving thrifts, would be able to serve the needs of borrowers, including home owners, as well as depositors.

EXHIBIT I

SUMMARY OF ALL INSURED THRIFTS
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
CT Totals, 26 Institutions	11,963,880	148	564,261	4.72	538,973	4.51	305,684	2.56	100.74	4.14	0.08	0.09	19,244	0.23	3,184	0.04	1.65
ME Totals, 14 Institutions	690,341	27	60,765	8.80	58,460	8.47	50,913	7.38	103.98	11.19	0.40	0.02	5,241	1.04	2,930	0.58	2.27
MA Totals, 30 Institutions	10,599,728	137	677,355	6.39	621,095	5.86	365,259	3.45	94.84	12.16	0.05	1.50	36,430	0.49	50,450	0.68	3.26
NH Totals, 11 Institutions	1,855,134	32	169,486	9.13	166,921	9.00	155,316	8.37	105.39	9.60	0.12	0.64	11,768	0.88	5,892	0.44	2.16
RI Totals, 5 Institutions	4,123,727	46	266,054	6.45	260,358	6.31	172,587	4.19	94.38	35.04	1.51	4.80	23,791	0.77	654	0.02	1.89
VT Totals, 4 Institutions	573,368	14	32,735	5.71	31,873	5.56	29,074	5.07	98.63	11.04	0.07	0.48	2,439	0.60	1,752	0.43	2.79
NJ Totals, 133 Institutions	55,683,865	922	2,729,409	4.90	2,306,701	4.16	1,156,713	2.08	97.24	12.45	0.45	0.95	240,676	0.59	80,191	0.20	2.00
NY Totals, 85 Institutions	59,176,839	746	3,140,984	5.31	2,531,920	4.28	53,058	0.09	95.71	12.56	0.26	1.57	269,156	0.63	86,105	0.20	1.92
PR Totals, 10 Institutions	6,631,607	121	462,313	6.97	352,623	5.32	317,939	4.79	102.57	9.39	0.24	1.01	53,294	1.10	33,666	0.70	2.40
VI Totals, 1 Institution	11,325	1	1,651	14.58	1,651	14.58	1,607	14.19	110.18	5.50	0	0	(285)	(5.07)	(292)	(5.19)	12.68
DE Totals, 4 Institutions	500,730	15	19,616	3.92	18,192	3.63	(305)	(0.06)	96.43	5.83	0	0.16	(374)	(0.11)	74	0.02	2.40
PA Totals, 169 Institutions	45,193,538	994	2,565,717	5.68	2,214,846	4.90	1,082,176	2.39	98.74	11.77	0.37	1.02	212,100	0.64	55,557	0.17	1.90
WV Totals, 16 Institutions	2,074,537	54	135,483	6.53	133,208	6.42	114,907	5.54	100.84	11.07	1.48	0.63	13,157	1.02	6,786	0.53	2.79
AL Totals, 37 Institutions	10,415,787	252	540,367	5.19	461,680	4.43	171,888	1.65	96.85	13.09	1.47	0.88	17,463	0.24	(23,630)	(0.33)	1.86
DC Totals, 6 Institutions	4,797,729	59	275,150	5.74	216,638	4.52	116,153	2.42	99.28	10.35	0.21	0.83	(7,512)	(0.22)	7,185	0.21	2.22
FL Totals, 165 Institutions	85,079,350	1,474	3,332,425	3.92	2,731,632	3.21	1,057,621	1.24	95.53	12.61	1.07	1.99	(45,416)	(0.07)	(259,780)	(0.43)	2.13
GA Totals, 71 Institutions	19,963,738	411	964,592	4.83	853,023	4.27	556,184	2.79	98.02	12.81	0.71	1.11	77,586	0.54	31,870	0.22	2.14
MD Totals, 99 Institutions	22,607,603	503	1,094,228	4.84	779,399	3.45	368,026	1.63	97.14	20.18	0.46	0.85	145,070	0.89	63,271	0.39	2.40
NC Totals, 134 Institutions	21,128,021	573	1,385,385	6.56	1,232,176	5.83	1,017,057	4.81	100.23	13.81	0.50	0.81	159,011	1.03	86,059	0.56	2.09
SC Totals, 49 Institutions	11,646,242	307	613,361	5.27	502,489	4.31	379,715	3.26	98.51	15.22	0.54	0.63	68,267	0.81	36,052	0.43	2.26
VA Totals, 62 Institutions	28,812,077	483	1,479,311	5.13	1,135,935	3.94	642,209	2.23	97.05	18.64	0.97	1.55	59,643	0.30	45,671	0.23	2.10
KY Totals, 64 Institutions	7,483,719	231	489,129	6.54	455,602	6.09	413,969	5.53	101.80	8.51	0.43	0.90	49,751	0.90	24,297	0.44	1.68
OH Totals, 224 Institutions	54,519,213	1,251	2,846,265	5.22	2,379,214	4.36	1,424,911	2.61	98.38	15.48	0.51	1.26	281,057	0.70	154,693	0.38	1.88
TN Totals, 60 Institutions	12,234,000	273	861,635	7.04	743,264	6.08	552,006	4.51	99.71	12.01	0.64	1.46	74,523	0.86	16,851	0.19	1.96

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SUMMARY OF ALL INSURED THRIFTS
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./Assets	Estimated GAAP Cap.	Est. GAAP Capital/Assets	Tangible Capital	Tangible Capital/Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assts	Net Repos Assets/Tot Asst	Serv.Corp Inv./Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/Avg Asst	Total Op. Exp/Avg Asst
IN Totals, 106 Institutions	13,782,713	373	885,222	6.42	823,310	5.97	618,207	4.49	100.43	7.50	0.45	0.27	97,982	0.98	50,402	0.51	1.78
MI Totals, 50 Institutions	39,119,786	653	1,899,087	4.85	1,518,411	3.88	1,011,762	2.59	100.45	7.02	0.22	0.31	160,527	0.50	102,279	0.36	1.44
IL Totals, 252 Institutions	68,427,928	1,001	4,384,240	6.41	3,574,651	5.22	1,778,116	2.60	98.83	10.19	0.65	0.98	339,382	0.48	103,271	0.31	1.93
WI Totals, 73 Institutions	16,982,444	907	1,166,808	6.87	1,147,446	6.76	1,091,083	6.42	102.79	13.44	0.70	0.89	120,834	0.99	69,141	0.57	2.32
IA Totals, 46 Institutions	9,706,438	298	265,531	2.76	177,925	1.83	45,956	0.47	94.83	16.09	2.46	1.01	10,845	0.15	(94,323)	(1.40)	1.79
MN Totals, 32 Institutions	15,536,263	255	601,857	3.88	296,435	1.91	(102,254)	(0.66)	91.79	15.09	0.76	2.97	6,816	0.06	4,976	0.06	1.86
MO Totals, 80 Institutions	24,803,229	440	920,367	3.71	618,260	2.49	293,441	1.03	98.09	13.05	1.38	0.57	69,428	0.27	(101,320)	(0.56)	1.60
ND Totals, 6 Institutions	4,581,619	93	210,333	4.59	141,799	3.09	8,740	0.19	95.13	9.89	0.70	2.02	16,295	0.49	4,357	0.13	1.42
SD Totals, 12 Institutions	1,410,755	55	64,327	4.56	50,164	3.56	27,095	1.92	97.76	20.02	1.31	0.24	14,010	1.32	6,109	0.38	2.05
AR Totals, 37 Institutions	6,655,807	220	(572,129)	(8.60)	(662,645)	(9.96)	(836,025)	(12.56)	82.29	27.25	6.16	1.86	(95,888)	(1.90)	(319,271)	(6.33)	2.60
LA Totals, 94 Institutions	15,106,080	365	738,142	4.89	589,975	3.91	28,638	0.19	90.24	20.23	3.32	3.19	(46,167)	(0.41)	(105,267)	(1.60)	1.96
MS Totals, 42 Institutions	5,323,613	196	174,821	3.28	78,067	1.47	(37,453)	(0.70)	89.86	15.83	2.36	3.20	5,036	0.13	(58,459)	(1.49)	2.44
NM Totals, 26 Institutions	5,580,271	133	(432,351)	(7.75)	(486,800)	(8.72)	(602,810)	(10.80)	83.41	22.34	3.80	2.36	(73,122)	(1.70)	(431,180)	(10.06)	2.40
TX Totals, 244 Institutions	108,410,670	1,602	(6,225,165)	(5.74)	(7,108,314)	(6.56)	(10,371,766)	(9.57)	70.97	21.64	11.90	4.10	(1,923,285)	(2.75)	(6,770,819)	(6.82)	1.86
CO Totals, 37 Institutions	15,296,570	224	110,469	0.72	25,832	0.17	(32,020)	(0.21)	91.68	24.30	4.82	1.23	(64,432)	(0.57)	(360,755)	(3.06)	1.82
KS Totals, 55 Institutions	22,903,378	260	914,525	3.99	780,303	3.41	685,102	2.99	97.41	10.93	1.62	2.02	27,460	0.17	21,731	0.13	1.48
NE Totals, 25 Institutions	12,068,739	273	196,062	1.62	122,512	1.02	(127,599)	(1.06)	91.67	12.13	2.06	2.05	(25,586)	(0.29)	(86,736)	(0.99)	1.79
OK Totals, 39 Institutions	10,686,909	246	327,292	3.06	314,522	2.94	46,918	0.44	90.15	12.98	5.06	2.39	(17,762)	(0.28)	(67,962)	(1.08)	1.85
AZ Totals, 11 Institutions	25,071,080	284	776,186	3.10	545,214	2.17	(160,485)	(0.64)	88.20	28.13	2.46	2.43	(163,080)	(0.80)	(193,095)	(1.05)	2.08
CA Totals, 195 Institutions	373,222,078	3,551	16,777,575	4.50	14,178,329	3.80	9,183,591	2.46	96.11	21.34	1.08	2.19	1,206,487	0.47	695,010	0.27	1.63
NV Totals, 5 Institutions	5,108,656	83	281,864	5.52	275,816	5.40	134,528	2.63	97.52	14.46	1.00	0.18	43,710	1.20	25,416	0.70	1.65
AK Totals, 3 Institutions	434,840	16	(82,942)	(19.07)	(84,150)	(19.35)	(84,594)	(19.45)	73.44	44.10	4.81	1.28	(14,477)	(4.00)	(63,522)	(17.57)	3.77
HI Totals, 6 Institutions	6,244,949	134	363,506	5.82	308,699	4.96	153,385	2.46	98.69	8.31	0.67	0.96	48,281	0.91	39,878	0.98	2.19
ID Totals, 6 Institutions	939,911	32	72,069	7.67	47,694	5.07	47,694	5.07	100.49	10.96	0.63	0.66	7,416	1.07	2,440	0.35	1.99

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SUMMARY OF ALL INSURED THRIFTS
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Conv/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
MT Totals, 11 Institutions	1,200,964	54	91,764	7.64	80,174	6.68	80,022	6.66	101.67	11.46	1.32	0.17	9,730	1.07	3,261	0.36	2.21
OR Totals, 12 Institutions	10,320,505	203	232,064	2.25	186,701	1.81	(419,390)	(4.06)	90.05	11.96	1.01	1.27	(7,862)	(0.11)	(12,937)	(0.18)	1.87
UT Totals, 13 Institutions	7,374,910	197	192,063	2.60	182,098	2.47	(161,391)	(2.19)	90.65	16.87	1.49	1.18	(16,570)	(0.31)	(6,482)	(0.12)	2.08
WA Totals, 35 Institutions	18,100,732	344	1,265,842	6.88	1,054,005	5.82	693,963	3.83	99.31	17.64	1.00	0.61	96,386	0.76	48,314	0.38	1.93
WY Totals, 11 Institutions	1,148,912	50	(67,386)	(5.87)	(80,419)	(7.00)	(80,479)	(7.00)	83.54	10.01	4.46	1.65	(22,993)	(2.60)	(36,759)	(4.16)	2.75
GU Totals, 2 Institutions	103,978	7	16,228	15.61	14,409	13.86	9,967	9.59	101.91	14.60	0	0.39	1,557	2.09	1,047	1.40	4.40
Grand Totals, 3023 Institutions	1,323,390,834	21,243	50,234,696	3.80	39,438,352	2.98	13,380,068	1.01	96.16	16.54	1.96	1.78	1,556,920	0.17	(5,081,785)	(0.56)	1.86

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Docket
Charter
District
Branches 21,243

ALL INSURED THRIFTS

EXHIBIT II

FINANCIAL HIGHLIGHTS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Total Assets	$ 920,384,660	$1,039,411,461	$1,165,762,464	$1,323,390,834
% Change in Assets	12.48%	12.93%	12.16%	13.52%
Regulatory Capital	43,455,630	54,388,982	54,241,828	50,234,696
Estimated GAAP Capital	32,903,995	42,609,057	43,294,922	39,438,332
Tangible Capital	12,389,553	21,617,825	18,693,819	13,388,068
Regulatory Capital/Total Assets	4.72%	5.23%	4.65%	3.80%
Est. GAAP Capital/Total Assets	3.58%	4.10%	3.71%	2.98%
Tangible Capital/Total Assets	1.35%	2.08%	1.60%	1.01%
Net Income (Loss)	4,678,987	3,984,708	(1,601,343)	(5,061,785)
Return on Average Assets	0.54%	0.41%	(0.15%)	(0.54%)
Return on Avg. Regulatory Cap.	12.17%	8.14%	(2.95%)	(12.97%)
Yield on Loans	11.44%	10.62%	9.62%	9.61%
Yield on Investments	9.37%	8.12%	8.00%	8.43%
Yield on Earning Assets	11.15%	10.27%	9.39%	9.45%
Cost of Savings	8.98%	7.82%	6.86%	7.20%
Cost of Borrowings	9.56%	8.87%	8.15%	8.06%
Cost of Funds	9.07%	8.00%	7.11%	7.38%
Yield/Cost Spread	2.08%	2.27%	2.28%	2.07%
Amt.Elig. for Reg. Liquidity	95,112,871	109,826,493	94,951,857	95,137,583
Amt.Elig. for Reg.Liq./Tot.Assets	10.33%	10.57%	8.15%	7.19%
Int.Earn.Asst./Int.Bear.Liab.	95.39%	95.97%	95.41%	94.16%
Loans & Participations Purchased	50,043,728	59,897,573	59,834,019	39,972,151
Loans & Participations Sold	79,447,368	130,052,003	115,402,575	75,028,679
Mortg. Loans Serviced for Others	203,217,951	255,733,359	308,001,372	347,109,746
Mortg. Loans Serviced by Others	107,142,219	107,782,941	113,271,715	122,325,617
Broker Originated Deposits	35,272,919	39,406,660	59,426,957	70,414,859
Cash Div. on Preferred Stock	42,988	62,136	109,297	96,017
Cash Div. on Permanent Stock	347,450	532,052	894,306	446,844
Cash Div. on Other Cap. Inst.	4,965	17,625	128,997	22,670
Non 1-4 Con./Conv.Ins./Tot.Asst	18.34%	17.98%	17.33%	16.54%
Balloon & Adj. Rate Loans	261,037,403	315,182,881	401,229,080	488,555,209
Ser.Corp.Inc./Inv.in Ser.Corp.	10.01%	7.77%	1.80%	1.74%
OTHER INFORMATION				
Annual Closing Date	N/A	N/A	N/A	N/A
No. of Wholly-Owned Ser. Corps.	3,405	3,790	0	N/A
No. of Deposit Accounts	98,303,479	101,032,295	105,145,915	110,932,745

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ALL INSURED THRIFTS
BALANCE SHEETS
(Dollars in Thousands)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	$ N/A	$ N/A	$ 20,690,041	$ 23,823,556
5 or More Dwelling Units	N/A	N/A	11,668,983	11,193,741
Nonresidential	N/A	N/A	16,968,821	17,024,638
Permanent Mortgages On:				
1-4 Dwelling Units	394,395,985	409,063,603	445,773,651	499,158,934
5 or More Dwelling Units	63,952,818	72,414,975	67,662,266	74,311,837
Nonresidential (Except Land)	82,141,821	89,802,893	81,093,825	90,008,818
Dev. Bldg. Lots, Land, Etc.	22,666,864	24,714,722	24,610,718	26,405,022
Mortgage Backed Securities	101,611,173	135,989,716	181,579,291	211,210,345
Accrued Interest Receivable	7,098,085	7,780,548	8,819,816	9,098,150
Other Mortgage Receivables	20,176,517	22,635,643	2,583,067	3,844,241
Loans in Process	(22,645,371)	(21,724,477)	(21,620,321)	(22,194,642)
Unearned Disc. & Def. Loan Fees	(10,626,495)	(8,329,024)	(8,345,138)	(8,109,558)
Specific Reserves & Val. Allow.	(2,513,594)	(4,465,297)	(7,071,027)	(8,208,669)
Net Mortgage Loans	656,257,809	727,883,291	824,413,995	927,566,435
Commercial Loans	13,686,968	20,302,359	20,841,785	24,181,838
Consumer Loans	39,352,623	46,062,735	53,960,882	59,894,260
Financing Leases	643,310	780,989	1,178,711	1,668,790
Accrued Interest Receivable	669,966	788,187	835,893	924,686
Loans in Process	(596,982)	(558,205)	(663,145)	(847,338)
Unearned Disc. & Def. Loan Fees	(872,975)	(928,711)	(744,491)	(572,678)
Specific Reserves & Val. Allow.	(426,001)	(839,455)	(1,368,297)	(1,647,928)
Net Nonmortgage Loans	52,456,961	65,607,886	74,041,367	83,601,661
Repossessed Assets	6,007,429	10,996,042	17,394,555	29,734,817
Valuation Allowances	(710,833)	(1,675,356)	(3,346,680)	(4,083,816)
Net Repossessed Assets	5,296,596	9,220,686	14,047,875	25,651,001
Real Estate Held For Dev., Etc.	4,408,100	5,405,378	5,829,496	8,180,207
Valuation Allowances	(183,440)	(279,472)	(537,538)	(740,277)
Net Real Estate Held for Dev.	4,224,660	5,125,906	5,291,958	7,439,930
Cash & Demand Deposits	11,985,732	15,807,392	15,234,453	17,078,395
U.S. Govt. & Agency Securities	36,601,282	42,226,719	47,233,976	41,083,057
Equity Sec., Except FHLB/FHLMC	1,178,442	1,160,383	1,165,969	3,734,160
Other Investments	76,625,178	91,040,104	95,368,208	118,677,405
Accrued Interest Receivable	1,537,347	1,533,548	1,843,593	2,100,673
Valuation Allowances	(59,943)	(142,060)	(330,044)	(383,247)
Net Cash & Investment Sec.	127,868,038	151,626,086	160,516,155	182,290,443
Net Fixed Assets	11,700,627	13,315,542	14,693,414	16,088,649
Investment in Ser. Corps./Subs.	16,727,275	18,010,077	20,587,495	23,584,266
Deferred Net Losses (Gains)	5,788,404	5,304,979	4,583,360	4,201,997
Intangible Assets	20,514,442	20,991,232	24,601,103	26,050,264
Other Assets	19,549,775	22,325,640	22,985,691	26,916,169
TOTAL ASSETS	$ 920,384,660	$1,039,411,461	$1,165,762,464	$1,323,390,834

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ALL INSURED THRIFTS
BALANCE SHEETS
(Dollars in Thousands)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	$ 520,059,301	$ 546,762,209	$ 616,966,001	$ 714,830,664
Transaction Accounts	31,828,356	47,378,132	53,622,198	60,565,671
Money Market Deposit Accounts	113,680,702	126,717,756	112,038,097	110,450,176
Passbook Accounts	57,137,449	73,545,917	83,720,295	87,728,988
Total Savings Deposits	722,705,808	794,404,014	866,346,591	973,575,499
FHLB Advances	71,570,371	87,564,904	107,745,210	123,389,588
Repurchase Agreements	38,634,863	46,470,329	70,189,889	93,972,552
Commercial Paper Issued	695,849	774,956	2,129,725	3,064,432
Sub.Deb. not Qual. as Reg.Cap.	624,698	233,798	196,961	335,020
Mortgage-Backed Bonds Issued	7,775,721	11,343,933	15,208,447	17,585,981
Other Borrowings	15,759,154	22,581,724	29,184,414	35,244,263
Other Liabilities	19,162,410	21,648,784	20,519,255	25,988,771
TOTAL LIABILITIES	876,929,026	985,022,473	1,111,520,631	1,273,156,142
REGULATORY CAPITAL				
Preferred Stock	219,010	259,305	935,620	1,429,415
Permanent Stock	1,026,406	1,300,001	1,642,189	1,983,023
Contributed Capital	9,678,068	16,102,929	18,749,608	20,899,449
Qualifying Mutual Cap. Cert.	3,106	5,533	5,943	11,641
Qualifying Subordinated Deb.	1,898,576	3,234,962	3,631,240	4,000,920
Appraised Equity Capital	1,521,133	2,063,346	1,898,308	1,774,347
Net Worth & Income Cap. Cert.	1,604,153	1,406,568	1,047,968	1,028,357
Retained Earnings (Deficit)	27,505,144	30,016,342	26,330,970	19,107,555
TOTAL REGULATORY CAPITAL	43,455,630	54,388,982	54,241,828	50,234,696
TOTAL LIAB. & REG. CAPITAL	$ 920,384,660	$1,039,411,452	$1,165,762,460	$1,323,390,837

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ALL INSURED THRIFTS
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 86,299,985	$ 89,631,238	$ 91,971,122	$ 77,166,447
Interest Expense	73,615,369	72,795,187	72,568,770	63,392,629
Net Interest Inc. (Exp.)	12,684,616	16,836,051	19,402,352	13,773,818
Other Operating Income:				
Mortgage Loan Fees	3,016,296	3,491,983	3,146,358	1,177,972
Loan Servicing Fees	615,114	829,672	1,017,429	847,188
Other Loan Fees & Charges	805,695	1,006,152	980,095	681,167
Ser.Chgs. & Fees - Trans.Accts.	533,163	685,639	823,981	728,982
Service Corps./Subsidiaries	1,461,405	1,349,868	348,094	287,466
Other	1,666,720	2,238,830	1,481,694	1,429,881
Total Oth. Operating Income	8,098,393	9,602,144	7,797,651	5,152,656
Operating Expense:				
Officers & Employees Comp.	6,393,694	7,689,203	8,775,706	6,948,140
Legal Expense	189,612	275,460	373,497	336,340
Office Occ. & Equip. Expense	3,122,362	3,698,878	4,197,682	3,464,651
Marketing Expense	718,953	785,449	893,047	673,483
Professional Services	316,057	427,270	505,684	421,032
Amortization of Goodwill	818,638	999,932	1,101,486	834,707
Other	4,829,988	5,727,304	6,213,195	4,691,201
Total Operating Expense	16,389,304	19,603,496	22,060,297	17,369,554
NET OPER. INCOME (DEFICIT)	4,393,705	6,834,699	5,139,706	1,556,920
Non-Operating Income:				
Profit on Sale of REO & Other	441,587	450,560	514,652	375,332
Profit on Sale of Investments	1,761,509	2,438,398	1,241,958	1,043,584
Profit on Sale of Loans	2,732,502	3,649,394	2,403,759	1,104,229
Amortized Deferred Gains	75,208	52,563	44,564	10,508
Other	799,742	847,113	1,128,201	770,145
Total Non-Operating Income	5,810,548	7,438,028	5,333,134	3,303,798
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	5,595,873	6,304,989
Loss on Sale of REO & Other	642,212	1,304,191	568,632	378,874
Loss on Sale of Investments	382,113	547,330	606,432	342,941
Loss on Sale of Loans	1,299,017	3,168,379	769,800	374,907
Amortized Deferred Losses	289,177	346,487	367,624	230,502
Other	460,908	1,070,494	1,359,885	356,708
Total Non-Operating Expense	3,073,427	6,436,881	9,268,246	7,988,921
INCOME (LOSS) BEF. TAXES & ADJ.	7,130,826	7,835,846	1,204,594	(3,128,203)
Income Taxes (Credits)	1,979,071	3,105,509	2,686,522	1,655,963
NET INCOME (LOSS) BEFORE ADJ.	5,150,731	4,730,151	(1,412,853)	(4,743,755)
Prior Period Adjustments	(471,756)	(745,439)	(188,487)	(338,030)
ADJUSTED NET INCOME (LOSS)	$ 4,678,987	$ 3,984,708	$ (1,601,343)	$ (5,081,785)

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ALL INSURED THRIFTS
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	N/A	N/A	1.77	1.80
5 or More Dwelling Units	N/A	N/A	1.00	0.85
Nonresidential	N/A	N/A	1.46	1.29
Permanent Mortgages On:				
1-4 Dwelling Units	42.85	39.36	38.24	37.72
5 or More Dwelling Units	6[illegible]5	6.97	5.80	5.62
Nonresidential (Except Land)	8[illegible]2	8.64	6.96	6.80
Dev. Bldg. Lots, Land, Etc.	2.46	2.38	2.11	2.00
Mortgage Backed Securities	11.04	13.08	15.58	15.96
Accrued Interest Receivable	0.77	0.75	0.76	0.69
Other Mortgage Receivables	2.19	2.18	0.22	0.29
Loans in Process	(2.46)	(2.09)	(1.85)	(1.68)
Unearned Disc. & Def. Loan Fees	(1.15)	(0.80)	(0.72)	(0.61)
Specific Reserves & Val. Allow.	(0.27)	(0.43)	(0.61)	(0.62)
Net Mortgage Loans	71.30	70.03	70.72	70.09
Commercial Loans	1.49	1.95	1.79	1.83
Consumer Loans	4.28	4.43	4.63	4.53
Financing Leases	0.07	0.08	0.10	0.13
Accrued Interest Receivable	0.07	0.08	0.07	0.07
Loans in Process	(0.06)	(0.05)	(0.06)	(0.06)
Unearned Disc. & Def. Loan Fees	(0.09)	(0.09)	(0.06)	(0.04)
Specific Reserves & Val. Allow.	(0.05)	(0.08)	(0.12)	(0.12)
Net Nonmortgage Loans	5.70	6.31	6.35	6.32
Repossessed Assets	0.65	1.05	1.49	2.25
Valuation Allowances	(0.08)	(0.16)	(0.29)	(0.31)
Net Repossessed Assets	0.58	0.89	1.21	1.94
Real Estate Held For Dev., Etc.	0.48	0.52	0.50	0.62
Valuation Allowances	(0.02)	(0.03)	(0.05)	(0.06)
Net Real Estate Held for Dev.	0.46	0.49	0.45	0.56
Cash & Demand Deposits	1.30	1.52	1.31	1.29
U.S. Govt. & Agency Securities	3.98	4.06	4.05	3.10
Equity Sec., Except FHLB/FHLMC	0.13	0.11	0.10	0.28
Other Investments	8.33	8.76	8.18	8.97
Accrued Interest Receivable	0.17	0.15	0.16	0.16
Valuation Allowances	(0.01)	(0.01)	(0.03)	(0.03)
Net Cash & Investment Sec.	13.89	14.59	13.77	13.77
Net Fixed Assets	1.27	1.28	1.26	1.22
Investment in Ser. Corps./Subs.	1.82	1.73	1.77	1.78
Deferred Net Losses (Gains)	0.63	0.51	0.39	0.32
Intangible Assets	2.23	2.02	2.11	1.97
Other	2.12	2.15	1.97	2.03
TOTAL ASSETS	100.00	100.00	100.00	100.00

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ALL INSURED THRIFTS
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	56.50	52.60	52.92	54.02
Transaction Accounts	3.46	4.56	4.60	4.58
Money Market Deposit Accounts	12.35	12.19	9.61	8.35
Passbook Accounts	6.21	7.08	7.18	6.63
Total Savings Deposits	78.52	76.43	74.32	73.57
FHLB Advances	7.78	8.42	9.24	9.32
Repurchase Agreements	4.20	4.47	6.02	7.10
Commercial Paper Issued	0.08	0.07	0.18	0.23
Sub. Deb. not Qual. as Reg. Cap.	0.07	0.02	0.02	0.03
Mortgage-Backed Bonds Issued	0.84	1.09	1.30	1.33
Other Borrowings	1.71	2.17	2.50	2.66
Other Liabilities	2.08	2.08	1.76	1.96
TOTAL LIABILITIES	95.28	94.77	95.35	96.20
REGULATORY CAPITAL				
Preferred Stock	0.02	0.02	0.08	0.11
Permanent Stock	0.11	0.13	0.14	0.15
Contributed Capital	1.05	1.55	1.61	1.58
Qualifying Mutual Cap. Cert.	0.00	0.00	0.00	0.00
Qualifying Subordinated Deb.	0.21	0.31	0.31	0.30
Appraised Equity Capital	0.17	0.20	0.16	0.13
Net Worth & Income Cap. Cert.	0.17	0.14	0.09	0.08
Retained Earnings (Deficit)	2.99	2.89	2.26	1.44
TOTAL REGULATORY CAPITAL	4.72	5.23	4.65	3.80
TOTAL LIABILITIES & REG. CAP.	100.00	100.00	100.00	100.00

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ALL INSURED THRIFTS
FINANCIAL RATIOS - STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	1985	1986	1987	9/30/88
Interest Income	9.93	9.15	8.34	8.27
Interest Expense	8.47	7.43	6.58	6.79
Net Interest Inc. (Exp.)	1.46	1.72	1.76	1.48
Other Operating Income:				
Mortgage Loan Fees	0.35	0.36	0.29	0.13
Loan Servicing Fees	0.07	0.08	0.09	0.09
Other Loan Fees & Charges	0.09	0.10	0.09	0.07
Ser.Chgs. & Fees-Trans.Accts	0.06	0.07	0.07	0.08
Service Corps./Subsidiaries	0.17	0.14	0.03	-0.03
Other	0.19	0.23	0.13	0.15
Total Oth. Operating Income	0.93	0.98	0.71	0.55
Operating Expense:				
Officers & Employees Comp.	0.74	0.78	0.80	0.74
Legal Expense	0.02	0.03	0.03	0.04
Office Occ. & Equip. Expense	0.36	0.38	0.38	0.37
Marketing Expense	0.08	0.08	0.08	0.07
Professional Services	0.04	0.04	0.05	0.05
Amortization of Goodwill	0.09	0.10	0.10	0.09
Other	0.56	0.58	0.56	0.50
Total Operating Expense	1.89	2.00	2.00	1.86
NET OPER. INCOME (DEFICIT)	0.51	0.70	0.47	0.17
Non-Operating Income:				
Profit on Sale of REO & Other	0.05	0.05	0.05	0.04
Profit on Sale of Investments	0.20	0.25	0.11	0.11
Profit on Sale of Loans	0.31	0.37	0.22	0.12
Amortized Deferred Gains	0.01	0.01	0.00	0.00
Other	0.09	0.09	0.10	0.08
Total Non-Operating Income	0.67	0.76	0.48	0.35
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	0.51	0.68
Loss on Sale of REO & Other	0.07	0.13	0.05	0.04
Loss on Sale of Investments	0.04	0.06	0.06	0.04
Loss on Sale of Loans	0.15	0.32	0.07	0.04
Amortized Deferred Losses	0.03	0.04	0.03	0.02
Other	0.05	0.11	0.12	0.04
Total Non-Operating Expense	0.35	0.66	0.84	0.86
INCOME (LOSS) BEF. TAXES & ADJ.	0.82	0.80	0.11	(0.34)
Income Taxes (Credits)	0.23	0.32	0.24	0.18
NET INCOME (LOSS) BEFORE ADJ.	0.59	0.48	(0.13)	(0.51)
Prior Period Adjustments	(0.05)	(0.08)	(0.02)	(0.04)
ADJUSTED NET INCOME (LOSS)	0.54	0.41	(0.15)	(0.54)

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ALL INSURED THRIFTS
QUARTERLY STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	$ 24,319,493	$ 24,724,917	$ 25,561,110	$ 26,880,420
Interest Expense	19,731,684	20,278,433	20,771,109	22,343,087
Net Interest Inc. (Exp.)	4,587,809	4,446,484	4,790,001	4,537,333
Other Operating Income:				
Mortgage Loan Fees	741,913	360,515	454,654	362,803
Loan Servicing Fees	274,961	263,992	288,018	295,178
Other Loan Fees & Charges	236,691	211,494	223,647	246,026
Ser.Chgs. & Fees-Trans.Accts	227,017	230,663	240,148	258,171
Service Corps./Subsidiaries	(243,251)	72,060	175,509	39,897
Other	377,622	451,685	415,141	563,055
Total Oth. Operating Income	1,614,953	1,590,409	1,797,117	1,765,130
Operating Expense:				
Officers & Employees Comp.	2,304,246	2,286,251	2,297,071	2,364,818
Legal Expense	111,343	99,565	117,622	119,153
Office Occ. & Equip. Expense	1,114,807	1,128,963	1,152,692	1,182,996
Marketing Expense	241,957	218,383	236,160	218,940
Professional Services	141,239	125,003	145,987	150,042
Amortization of Goodwill	330,905	271,704	277,203	285,800
Other	1,688,319	1,524,331	1,563,841	1,603,029
Total Operating Expense	5,932,816	5,654,200	5,790,576	5,924,778
NET OPER. INCOME (DEFICIT)	269,946	382,693	796,542	377,685
Non-Operating Income:				
Profit on Sale of REO & Other	161,656	106,860	143,457	125,015
Profit on Sale of Investments	281,196	308,910	262,540	472,134
Profit on Sale of Loans	320,189	498,705	340,785	264,739
Amortized Deferred Gains	7,766	3,629	3,317	3,562
Other	397,991	151,903	261,225	357,017
Total Non-Operating Income	1,168,798	1,070,007	1,011,324	1,222,467
Non-Operating Expense:				
Provision for Losses on Assets	2,307,524	1,844,356	2,394,403	2,066,230
Loss on Sale of REO & Other	168,967	120,559	121,251	137,064
Loss on Sale of Investments	183,731	90,415	105,908	146,618
Loss on Sale of Loans	218,921	136,206	149,736	88,965
Amortized Deferred Losses	87,905	74,055	80,229	76,218
Other	204,291	93,524	138,282	124,902
Total Non-Operating Expense	3,171,339	2,359,115	2,989,809	2,639,997
INCOME (LOSS) BEF. TAXES & ADJ.	(1,732,595)	(906,415)	(1,181,943)	(1,039,845)
Income Taxes (Credits)	432,051	494,953	579,271	581,739
NET INCOME (LOSS) BEFORE ADJ.	(2,126,750)	(1,360,981)	(1,761,192)	(1,621,582)
Prior Period Adjustments	(91,662)	(132,458)	(38,295)	(167,277)
ADJUSTED NET INCOME (LOSS)	$ (2,218,415)	$ (1,493,439)	$ (1,799,485)	$ (1,788,861)

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ALL INSURED THRIFTS
FINANCIAL RATIOS - QUARTERLY STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	8.82	7.95	8.22	8.64
Interest Expense	7.16	6.52	6.68	7.18
Net Interest Inc. (Exp.)	1.66	1.43	1.54	1.46
Other Operating Income:				
Mortgage Loan Fees	0.27	0.12	0.15	0.12
Loan Servicing Fees	0.10	0.08	0.09	0.09
Other Loan Fees & Charges	0.09	0.07	0.07	0.08
Ser.Chgs. & Fees-Trans.Accts	0.08	0.07	0.08	0.08
Service Corps./Subsidiaries	(0.09)	0.02	0.06	0.01
Other	0.14	0.15	0.13	0.18
Total Other Oper. Income	0.59	0.51	0.58	0.57
Operating Expense:				
Officers & Employees Comp.	0.84	0.73	0.74	0.76
Legal Expense	0.04	0.03	0.04	0.04
Office Occ. & Equip. Expense	0.40	0.36	0.37	0.38
Marketing Expense	0.09	0.07	0.08	0.07
Professional Services	0.05	0.04	0.05	0.05
Amortization of Goodwill	0.12	0.09	0.09	0.09
Other	0.61	0.49	0.50	0.52
Total Operating Expense	2.15	1.82	1.86	1.90
NET OPER. INCOME (DEFICIT)	0.10	0.12	0.26	0.12
Non-Operating Income:				
Profit on Sale of REO & Other	0.06	0.03	0.05	0.04
Profit on Sale of Investments	0.10	0.10	0.08	0.15
Profit on Sale of Loans	0.12	0.16	0.11	0.09
Amortized Deferred Gaihs	0.00	0.00	0.00	0.00
Other	0.14	0.05	0.08	0.11
Total Non-Operating Income	0.42	0.34	0.33	0.39
Non-Operating Expense:				
Provision for Losses on Assets	0.84	0.59	0.77	0.66
Loss on Sale of REO & Other	0.06	0.04	0.04	0.04
Loss on Sale of Investments	0.07	0.03	0.03	0.05
Loss on Sale of Loans	0.08	0.04	0.05	0.03
Amortized Deferred Losses	0.03	0.02	0.03	0.02
Other	0.07	0.03	0.04	0.04
Total Non-Operating Expense	1.15	0.76	0.96	0.85
INCOME (LOSS) BEF. TAXES & ADJ.	(0.63)	(0.29)	(0.38)	(0.33)
Income Taxes (Credits)	0.16	0.16	0.19	0.19
NET INCOME (LOSS) BEFORE ADJ.	(0.77)	(0.44)	(0.57)	(0.52)
Prior Period Adjustments	(0.03)	(0.04)	(0.01)	(0.05)
ADJUSTED NET INCOME (LOSS)	(0.80)	(0.48)	(0.58)	(0.57)

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EXHIBIT III

SUMMARY OF THRIFTS WITH GAAP CAPITAL GREATER THAN OR EQUAL TO 6% WITH
TANGIBLE CAPITAL GREATER THAN $0
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
CT Totals, 11 Institutions	2,123,090	44	212,673	10.02	203,337	9.58	203,337	9.58	107.46	7.79	0.16	0.05	17,990	1.18	10,656	0.70	1.89
ME Totals, 10 Institutions	487,422	16	49,664	10.19	48,894	10.03	48,894	10.03	107.36	11.76	0.55	0.02	4,336	1.21	2,538	0.71	2.14
MA Totals, 17 Institutions	2,279,473	56	201,075	8.82	194,613	8.54	194,613	8.54	105.61	15.07	0.06	0.46	18,419	1.13	10,736	0.66	2.32
NH Totals, 9 Institutions	1,568,639	30	155,080	9.89	154,132	9.83	149,277	9.52	106.15	10.02	0.13	0.42	11,476	1.02	6,117	0.54	2.08
RI Totals, 3 Institutions	3,855,434	44	257,255	6.67	251,900	6.53	168,123	4.36	95.85	37.15	1.56	5.14	23,849	0.80	785	0.03	1.93
VT Totals, 1 Institution	18,351	1	1,339	7.30	1,339	7.30	1,339	7.30	101.54	5.65	0.01	0	56	0.42	73	0.55	2.35
NJ Totals, 50 Institutions	11,079,025	213	996,974	9.00	957,662	8.64	927,117	8.37	105.05	13.16	0.05	0.80	139,688	1.75	88,577	1.11	1.66
NY Totals, 40 Institutions	13,656,059	172	1,134,233	8.31	1,054,510	7.72	1,022,647	7.49	105.63	12.06	0.09	0.45	152,643	1.54	88,623	0.90	1.75
PR Totals, 4 Institutions	1,989,339	54	143,808	7.23	143,572	7.22	143,016	7.19	104.21	11.49	0.36	0.38	10,084	0.68	8,948	0.61	2.27
VI Totals, 1 Institution	11,325	1	1,651	14.58	1,651	14.58	1,607	14.19	110.18	5.50	0	0	(285)	(5.07)	(292)	(5.19)	12.68
PA Totals, 95 Institutions	13,486,644	374	1,202,594	8.92	1,171,176	8.68	1,071,005	7.94	105.20	10.72	0.20	0.62	134,973	1.39	84,238	0.87	1.96
WV Totals, 8 Institutions	871,265	32	81,553	9.36	81,553	9.36	79,488	9.12	105.82	10.68	0.53	0.09	7,322	1.13	4,260	0.66	2.07
AL Totals, 17 Institutions	4,433,771	89	442,608	9.98	409,192	9.23	254,929	5.75	102.58	10.86	0.98	0.35	24,878	0.90	26,100	0.94	1.93
DC Totals, 2 Institutions	949,975	15	81,551	8.58	80,430	8.47	44,258	4.66	97.23	6.90	0.04	0.78	(11,648)	(1.57)	505	0.07	4.06
FL Totals, 49 Institutions	16,433,432	287	1,523,086	9.27	1,520,787	9.25	1,048,449	6.38	101.74	7.36	0.41	1.48	61,428	0.55	35,990	0.32	2.32
GA Totals, 34 Institutions	3,910,005	96	313,670	8.02	307,779	7.87	285,212	7.29	103.10	16.11	0.44	0.66	34,371	1.23	22,251	0.79	2.34
MD Totals, 57 Institutions	4,802,869	140	411,662	8.57	403,544	8.40	397,874	8.28	105.09	12.64	0.48	0.48	57,784	1.66	36,963	1.06	1.81
NC Totals, 86 Institutions	10,376,802	273	914,711	8.81	886,871	8.55	846,630	8.16	105.36	11.50	0.31	0.38	118,989	1.57	68,726	0.91	1.78
SC Totals, 27 Institutions	3,469,525	87	276,990	7.98	268,100	7.73	269,954	7.20	104.34	18.12	0.29	0.40	34,565	1.39	21,970	0.88	2.01
VA Totals, 15 Institutions	2,988,520	63	234,023	7.83	231,786	7.76	206,233	6.90	103.21	15.53	0.20	0.44	28,618	1.35	20,486	0.97	1.52
KY Totals, 34 Institutions	3,662,013	96	337,459	9.22	332,170	9.07	315,936	8.63	105.02	9.03	0.14	0.98	31,283	1.16	23,450	0.87	1.53
OH Totals, 126 Institutions	17,047,934	426	1,372,228	8.05	1,337,752	7.85	1,262,282	7.40	104.86	12.55	0.19	0.82	184,966	1.48	118,816	0.95	1.69
TN Totals, 26 Institutions	6,435,624	155	589,688	9.16	576,358	8.96	491,659	7.64	104.58	13.19	0.42	0.26	57,608	1.23	9,807	0.21	1.94
IN Totals, 60 Institutions	5,626,432	158	509,258	9.05	503,708	8.95	450,718	8.01	104.89	8.78	0.30	0.20	56,159	1.36	32,586	0.79	1.75

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SUMMARY OF THRIFTS WITH GAAP CAPITAL GREATER THAN OR EQUAL TO 6% WITH
TANGIBLE CAPITAL GREATER THAN $0
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
MI Totals, 15 Institutions	2,624,626	93	211,664	8.06	211,664	8.06	186,406	7.10	105.40	4.85	0.37	0.17	21,295	1.09	14,761	0.75	2.03
IL Totals, 93 Institutions	24,542,428	317	3,251,405	13.25	3,098,549	12.63	2,941,369	11.98	110.79	13.03	0.19	0.80	302,672	1.68	187,317	1.04	1.77
WI Totals, 51 Institutions	10,276,533	284	893,361	8.71	895,361	8.71	876,435	8.53	106.21	11.94	0.30	0.80	83,498	1.13	57,075	0.77	2.21
IA Totals, 11 Institutions	1,351,168	41	103,408	7.65	95,623	7.08	66,182	4.90	94.17	13.31	4.34	2.92	6,900	0.90	3,745	0.49	2.29
MN Totals, 8 Institutions	619,881	22	51,580	8.32	48,149	7.77	47,762	7.71	105.80	7.04	0.40	0.22	6,227	1.34	3,232	0.70	1.79
MO Totals, 35 Institutions	7,025,910	179	492,315	7.01	484,068	6.89	481,151	6.85	103.44	6.85	0.95	0.37	51,756	1.01	33,598	0.66	1.39
SD Totals, 2 Institutions	156,119	5	12,752	8.17	12,752	8.17	12,752	8.17	104.11	15.42	1.64	0.96	2,426	2.07	1,368	1.17	1.60
AR Totals, 4 Institutions	238,474	5	22,529	9.45	22,529	9.45	20,293	8.51	105.71	11.97	0.81	0.05	2,476	1.44	1,[illegible]03	0.93	1.39
LA Totals, 24 Institutions	4,901,627	72	1,017,454	20.76	1,009,169	20.59	847,955	17.30	106.94	33.60	1.39	8.56	52,595	1.51	39,883	1.14	1.38
MS Totals, 11 Institutions	993,002	41	81,392	8.20	69,422	6.99	39,678	4.00	90.89	10.98	2.17	5.92	4,658	0.61	3,415	0.47	2.43
NM Totals, 7 Institutions	439,764	11	41,489	9.43	38,005	8.64	38,005	8.64	105.44	10.15	0.77	0.35	4,248	1.30	1,939	0.60	1.90
TX Totals, 34 Institutions	3,423,475	71	368,807	10.77	364,346	10.64	347,263	10.14	100.61	10.34	1.65	2.88	41,578	1.77	18,127	0.77	3.82
CO Totals, 11 Institutions	4,853,765	73	362,371	7.47	356,535	7.35	356,061	7.34	101.16	9.12	2.16	0.67	25,999	0.73	5,736	0.16	1.86
KS Totals, 16 Institutions	4,180,181	69	354,045	8.47	315,009	7.54	313,722	7.50	106.35	5.33	0.47	0.18	45,626	1.53	27,909	0.96	1.25
NE Totals, 7 Institutions	374,991	12	37,131	9.90	37,131	9.90	37,131	9.90	106.36	11.10	0.74	0.01	3,338	1.37	1,518	0.62	1.77
OK Totals, 8 Institutions	419,424	13	74,050	17.66	73,628	17.55	59,950	14.29	88.09	5.72	1.11	16 61	(1,488)	(0.55)	(3,938)	(1.46)	2.26
AZ Totals, 3 Institutions	7,344,271	77	522,273	7.11	445,835	6.07	73,179	1.00	86.95	26.28	2.26	1.51	(4,033)	(0.08)	(9,060)	(0.17)	2.11
CA Totals, 44 Institutions	49,853,019	669	4,152,221	8.33	3,696,200	7.41	2,731,357	5.48	100.93	28.83	0.61	2.44	310,546	0.85	184,963	0.51	1.76
NV Totals, 1 Institution	58,779	1	3,914	6.66	3,914	6.66	3,914	6.66	101.01	7.71	0	0	(309)	(0.77)	41	0.10	4.12
HI Totals, 2 Institutions	2,080,820	60	213,965	10.28	202,820	9.75	141,052	6.78	102.09	6.63	0.42	0.72	24,633	1.66	19,056	1.28	2.34
ID Totals, 2 Institutions	315,747	10	26,786	8.48	24,422	7.73	24,422	7.73	102.78	17.89	0.89	0.38	3,656	1.61	2,459	1.08	2.69
MT Totals, 6 Institutions	571,458	26	69,160	12.10	68,942	12.06	68,942	12.06	108.87	13.51	1.46	0.20	6,709	1.56	3,440	0.80	2.07
OR Totals, 2 Institutions	611,919	11	46,781	7.64	46,782	7.65	42,590	6.96	102.42	13.64	0.68	0.95	5,417	1.36	3,634	0.91	1.78
UT Totals, 4 Institutions	3,687,961	42	261,130	7.08	257,020	6.97	87,308	2.37	96.16	18.12	0.86	1.39	4,153	0.16	(5,070)	(0.19)	1.77

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SUMMARY OF THRIFTS WITH GAAP CAPITAL GREATER THAN OR EQUAL TO 6% WITH
TANGIBLE CAPITAL GREATER THAN $0
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
WA Totals, 12 Institutions	5,563,809	115	558,450	10.04	541,510	9.73	469,553	8.44	102.76	12.85	1.30	0.68	68,004	1.76	41,130	1.06	1.80
WY Totals, 5 Institutions	276,215	12	26,430	9.57	26,430	9.57	26,430	9.57	105.11	6.09	1.31	0.39	3,091	1.50	1,237	0.60	1.94
GU Totals, 2 Institutions	103,978	7	16,228	15.61	14,409	13.86	9,967	9.59	101.91	14.60	0	0.39	1,557	2.09	1,047	1.40	4.40
Grand Totals, 1202 Institutions	268,452,270	5,260	24,719,924	9.21	23,583,040	8.78	20,215,422	7.53	103.47	15.76	0.56	1.31	2,276,580	1.18	1,363,072	0.71	1.87

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Docket
Charter
District
Branches 5,260

THRIFTS W/GAAP CAP>6%, TAN. CAP>$0

EXHIBIT IV

FINANCIAL HIGHLIGHTS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Total Assets	$ 195,726,855	$ 221,795,034	$ 246,937,838	$ 268,452,270
% Change in Assets	11.88%	13.32%	11.34%	8.71%
Regulatory Capital	14,508,922	19,868,856	22,462,285	24,719,924
Estimated GAAP Capital	13,170,640	18,491,482	21,227,273	23,583,040
Tangible Capital	11,186,647	16,240,945	18,245,090	20,215,422
Regulatory Capital/Total Assets	7.41%	8.96%	9.10%	9.21%
Est. GAAP Capital/Total Assets	6.73%	8.34%	8.60%	8.78%
Tangible Capital/Total Assets	5.72%	7.32%	7.39%	7.53%
Net Income (Loss)	1,409,890	2,107,716	1,880,305	1,363,072
Return on Average Assets	0.76%	1.01%	0.80%	0.71%
Return on Avg. Regulatory Cap.	11.32%	12.26%	8.88%	7.70%
Yield on Loans	11.26%	10.44%	9.74%	9.73%
Yield on Investments	9.52%	8.55%	8.04%	8.29%
Yield on Earning Assets	10.98%	10.14%	9.48%	9.54%
Cost of Savings	8.78%	7.63%	6.73%	6.97%
Cost of Borrowings	9.54%	8.60%	7.96%	7.93%
Cost of Funds	8.84%	7.72%	6.87%	7.09%
Yield/Cost Spread	2.14%	2.42%	2.61%	2.45%
Amt.Elig. for Reg. Liquidity	26,930,461	30,058,378	27,437,316	24,691,718
Amt.Elig. for Reg.Liq./Tot.Assets	13.76%	13.55%	11.11%	9.20%
Int.Earn.Asst./Int.Bear.Liab.	102.14%	10[illegible].45%	103.51%	103.47%
Loans & Participations Purchased	8,661,807	11,112,059	13,157,123	7,229,807
Loans & Participations Sold	10,010,290	20,387,367	18,473,970	11,846,804
Mortg. Loans Serviced for Others	30,299,479	39,130,187	47,182,617	50,722,862
Mortg. Loans Serviced by Others	16,139,263	17,735,212	20,666,260	21,036,841
Broker Originated Deposits	5,385,586	6,638,611	10,009,982	9,234,515
Cash Div. on Preferred Stock	9,251	18,585	13,164	22,993
Cash Div. on Permanent Stock	76,400	91,264	210,952	125,158
Cash Div. on Other Cap. Inst.	122	5	54,776	2
Non 1-4 Con./Conv.Ins./Tot.Asst	14.95%	15.19%	16.30%	15.76%
Balloon & Adj. Rate Loans	49,176,790	62,475,360	86,071,730	103,299,110
Ser.Corp.Inc./Inv.in Ser.Corp.	7.67%	8.66%	4.32%	5.18%
OTHER INFORMATION				
Annual Closing Date	N/A	N/A	N/A	N/A
No. of Wholly-Owned Ser. Corps.	877	940	0	N/A
No. of Deposit Accounts	23,878,187	24,293,157	25,620,211	26,421,061

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
BALANCE SHEETS
(Dollars in Thousands)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	$ N/A	$ N/A	$ 5,432,918	$ 6,523,150
5 or More Dwelling Units	N/A	N/A	2,070,629	2,124,979
Nonresidential	N/A	N/A	2,921,027	3,151,795
Permanent Mortgages On:				
1-4 Dwelling Units	97,769,076	105,295,956	116,042,642	126,517,875
5 or More Dwelling Units	12,008,148	14,595,109	14,690,695	15,015,677
Nonresidential (Except Land)	14,815,211	16,245,454	16,368,548	17,464,933
Dev. Bldg. Lots, Land, Etc.	2,433,028	2,857,193	4,193,576	4,559,908
Mortgage Backed Securities	16,317,117	21,534,246	24,883,267	30,433,016
Accrued Interest Receivable	1,135,487	1,257,136	1,458,757	1,556,730
Other Mortgage Receivables	4,263,985	4,268,742	315,399	434,953
Loans in Process	(3,918,486)	(4,025,628)	(4,641,560)	(5,208,983)
Unearned Disc. & Def. Loan Fees	(1,580,620)	(1,225,004)	(1,352,748)	(1,526,426)
Specific Reserves & Val. Allow.	(370,199)	(518,372)	(690,947)	(685,919)
Net Mortgage Loans	142,872,742	160,284,840	181,692,202	200,361,703
Commercial Loans	2,436,822	3,154,917	3,430,090	4,002,241
Consumer Loans	7,978,198	9,597,592	11,007,617	11,515,733
Financing Leases	69,056	101,992	139,153	155,176
Accrued Interest Receivable	110,330	154,578	135,658	170,828
Loans in Process	(30,390)	(89,237)	(76,858)	(91,391)
Unearned Disc. & Def. Loan Fees	(420,657)	(412,324)	(304,514)	(216,096)
Specific Reserves & Val. Allow.	(84,452)	(126,417)	(179,716)	(206,693)
Net Nonmortgage Loans	10,058,912	12,381,111	14,151,462	15,329,817
Repossessed Assets	718,514	1,028,579	1,413,335	1,821,200
Valuation Allowances	(78,687)	(132,256)	(229,745)	(310,636)
Net Repossessed Assets	639,827	896,323	1,183,590	1,510,564
Real Estate Held For Dev., Etc.	515,186	365,963	508,419	584,974
Valuation Allowances	(15,986)	(15,337)	(63,610)	(38,058)
Net Real Estate Held for Dev.	499,200	350,626	444,809	546,916
Cash & Demand Deposits	2,357,442	3,131,492	3,081,395	3,635,047
U.S. Govt. & Agency Securities	10,001,052	10,703,117	10,323,446	9,163,064
Equity Sec., Except FHLB/FHLMC	266,843	243,826	292,835	1,040,067
Other Investments	18,585,362	21,662,524	22,299,181	22,195,093
Accrued Interest Receivable	413,048	383,321	386,580	406,059
Valuation Allowances	(3,345)	(14,244)	(54,299)	(52,749)
Net Cash & Investment Sec.	31,620,402	36,110,036	36,329,138	36,386,581
Net Fixed Assets	2,329,418	2,625,856	2,934,664	3,142,829
Investment in Ser. Corps./Subs.	2,226,276	2,706,298	3,177,365	3,523,779
Deferred Net Losses (Gains)	544,206	382,051	294,636	237,145
Intangible Assets	1,983,993	2,250,537	2,982,183	3,367,618
Other Assets	2,951,883	3,807,312	3,747,735	4,045,303
TOTAL ASSETS	$ 195,726,855	$ 221,795,034	$ 246,937,838	$ 268,452,270

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
BALANCE SHEETS
(Dollars in Thousands)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	$ 113,188,030	$ 117,076,827	$ 131,039,159	$ 144,536,534
Transaction Accounts	6,487,364	9,351,313	11,032,596	12,104,558
Money Market Deposit Accounts	25,752,618	30,149,974	27,634,957	26,569,248
Passbook Accounts	16,553,737	20,157,677	23,169,687	23,952,356
Total Savings Deposits	161,981,749	176,735,791	192,876,399	207,162,696
FHLB Advances	7,667,810	10,613,854	14,849,044	15,526,790
Repurchase Agreements	3,497,475	4,559,896	6,871,285	9,529,014
Commercial Paper Issued	299,558	333,558	385,285	773,738
Sub.Deb. not Qual. as Reg.Cap.	202,915	26,540	24,060	25,791
Mortgage-Backed Bonds Issued	766,836	1,685,180	1,019,269	1,214,788
Other Borrowings	2,779,878	3,722,350	4,267,937	4,715,216
Other Liabilities	4,021,638	4,249,012	4,182,263	4,784,299
TOTAL LIABILITIES	181,217,928	201,926,177	224,475,552	243,732,351
REGULATORY CAPITAL				
Preferred Stock	4,272	13,476	98,485	278,641
Permanent Stock	294,425	396,314	552,679	610,911
Contributed Capital	4,044,494	7,122,246	8,131,147	9,021,969
Qualifying Mutual Cap. Cert.	0	0	0	0
Qualifying Subordinated Deb.	536,594	704,034	680,132	670,192
Appraised Equity Capital	137,369	219,348	198,434	168,281
Net Worth & Income Cap. Cert.	135,562	82,657	72,744	72,222
Retained Earnings (Deficit)	9,356,174	11,330,788	12,728,661	13,897,707
TOTAL REGULATORY CAPITAL	14,508,922	19,868,856	22,462,285	24,719,924
TOTAL LIAB. & REG. CAPITAL	$ 195,726,851	$ 221,795,031	$ 246,937,837	$ 268,452,276

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 18,839,534	$ 19,561,543	$ 20,529,217	$ 17,015,286
Interest Expense	14,952,285	14,465,200	14,377,144	12,225,839
Net Interest Inc. (Exp.)	3,887,249	5,096,343	6,152,073	4,789,447
Other Operating Income:				
Mortgage Loan Fees	596,105	820,165	749,603	262,398
Loan Servicing Fees	98,395	124,624	159,816	126,650
Other Loan Fees & Charges	171,724	214,406	207,353	129,586
Ser.Chgs. & Fees - Trans.Accts.	93,697	121,713	153,126	136,518
Service Corps./Subsidiaries	160,460	213,679	127,108	130,109
Other	326,199	393,143	349,431	313,976
Total Oth. Operating Income	1,446,580	1,887,730	1,746,437	1,099,237
Operating Expense:				
Officers & Employees Comp.	1,420,740	1,730,276	1,969,415	1,578,097
Legal Expense	30,163	40,766	48,349	38,849
Office Occ. & Equip. Expense	637,233	758,598	880,531	720,504
Marketing Expense	150,078	167,973	200,813	156,939
Professional Services	55,078	73,907	90,916	81,943
Amortization of Goodwill	98,690	101,118	144,874	110,596
Other	977,857	1,138,478	1,259,347	925,176
Total Operating Expense	3,369,839	4,011,116	4,594,245	3,612,104
NET OPER. INCOME (DEFICIT)	1,963,990	2,972,957	3,304,265	2,276,580
Non-Operating Income:				
Profit on Sale of REO & Other	48,601	45,957	59,378	37,675
Profit on Sale of Investments	226,938	334,342	174,570	152,469
Profit on Sale of Loans	291,301	443,892	237,376	127,146
Amortized Deferred Gains	4,692	5,048	5,032	889
Other	113,835	109,006	218,963	93,709
Total Non-Operating Income	685,367	938,245	695,319	411,888
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	395,059	290,198
Loss on Sale of REO & Other	83,581	133,245	72,528	55,665
Loss on Sale of Investments	125,755	43,921	78,539	47,266
Loss on Sale of Loans	191,291	305,152	121,034	60,829
Amortized Deferred Losses	29,765	41,942	35,514	16,550
Other	72,717	131,547	241,795	48,228
Total Non-Operating Expense	503,109	655,807	944,469	518,736
INCOME (LOSS) BEF. TAXES & ADJ.	2,146,248	3,255,395	3,055,115	2,169,732
Income Taxes (Credits)	657,237	1,107,241	1,180,214	747,508
NET INCOME (LOSS) BEFORE ADJ.	1,488,619	2,148,129	1,883,341	1,426,431
Prior Period Adjustments	(78,728)	(40,403)	(3,042)	(63,356)
ADJUSTED NET INCOME (LOSS)	$ 1,409,890	$ 2,107,716	$ 1,880,305	$ 1,363,072

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	N/A	N/A	2.20	2.43
5 or More Dwelling Units	N/A	N/A	0.84	0.79
Nonresidential	N/A	N/A	1.18	1.17
Permanent Mortgages On:				
1-4 Dwelling Units	49.95	47.47	46.99	47.13
5 or More Dwelling Units	6.14	6.58	5.95	5.59
Nonresidential (Except Land)	7.57	7.32	6.63	6.51
Dev. Bldg. Lots, Land, Etc.	1.24	1.29	1.70	1.70
Mortgage Backed Securities	8.34	9.71	10.08	11.34
Accrued Interest Receivable	0.58	0.57	0.59	0.58
Other Mortgage Receivables	2.18	1.92	0.13	0.16
Loans in Process	(2.00)	(1.82)	(1.88)	(1.94)
Unearned Disc. & Def. Loan Fees	(0.81)	(0.55)	(0.55)	(0.57)
Specific Reserves & Val. Allow.	(0.19)	(0.23)	(0.28)	(0.26)
Net Mortgage Loans	73.00	72.27	73.58	74.64
Commercial Loans	1.25	1.42	1.39	1.49
Consumer Loans	4.08	4.33	4.46	4.29
Financing Leases	0.04	0.05	0.06	0.06
Accrued Interest Receivable	0.06	0.07	0.05	0.06
Loans in Process	(0.02)	(0.04)	(0.03)	(0.03)
Unearned Disc. & Def. Loan Fees	(0.21)	(0.19)	(0.12)	(0.08)
Specific Reserves & Val. Allow.	(0.04)	(0.06)	(0.07)	(0.08)
Net Nonmortgage Loans	5.14	5.58	5.73	5.71
Repossessed Assets	0.37	0.46	0.57	0.68
Valuation Allowances	(0.04)	(0.06)	(0.09)	(0.12)
Net Repossessed Assets	0.33	0.40	0.48	0.56
Real Estate Held For Dev., Etc.	0.26	0.17	0.21	0.22
Valuation Allowances	(0.01)	(0.01)	(0.03)	(0.01)
Net Real Estate Held for Dev.	0.26	0.16	0.18	0.20
Cash & Demand Deposits	1.20	1.41	1.25	1.35
U.S. Govt. & Agency Securities	5.11	4.83	4.18	3.41
Equity Sec., Except FHLB/FHLMC	0.14	0.11	0.12	0.39
Other Investments	9.50	9.77	9.03	8.27
Accrued Interest Receivable	0.21	0.17	0.16	0.15
Valuation Allowances	0.00	(0.01)	(0.02)	(0.02)
Net Cash & Investment Sec.	16.16	16.28	14.71	13.55
Net Fixed Assets	1.19	1.18	1.19	1.17
Investment in Ser. Corps./Subs.	1.14	1.22	1.29	1.31
Deferred Net Losses (Gains)	0.28	0.17	0.12	0.09
Intangible Assets	1.01	1.01	1.21	1.25
Other	1.51	1.72	1.52	1.51
TOTAL ASSETS	100.00	100.00	100.00	100.00

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	57.83	52.79	53.07	53.84
Transaction Accounts	3.31	4.22	4.47	4.51
Money Market Deposit Accounts	13.16	13.59	11.19	9.90
Passbook Accounts	8.46	9.09	9.38	8.92
Total Savings Deposits	82.76	79.68	78.11	77.17
FHLB Advances	3.92	4.79	6.01	5.78
Repurchase Agreements	1.79	2.06	2.78	3.55
Commercial Paper Issued	0.15	0.15	0.16	0.29
Sub. Deb. not Qual. as Reg. Cap.	0.10	0.01	0.01	0.01
Mortgage-Backed Bonds Issued	0.39	0.76	0.41	0.45
Other Borrowings	1.42	1.68	1.73	1.76
Other Liabilities	2.05	1.92	1.69	1.78
TOTAL LIABILITIES	92.59	91.04	90.90	90.79
REGULATORY CAPITAL				
Preferred Stock	0.00	0.01	0.04	0.10
Permanent Stock	0.15	0.18	0.22	0.23
Contributed Capital	2.07	3.21	3.29	3.36
Qualifying Mutual Cap. Cert.	0.00	0.00	0.00	0.00
Qualifying Subordinated Deb.	0.27	0.32	0.28	0.25
Appraised Equity Capital	0.07	0.10	0.08	0.06
Net Worth & Income Cap. Cert.	0.07	0.04	0.03	0.03
Retained Earnings (Deficit)	4.78	5.11	5.15	5.18
TOTAL REGULATORY CAPITAL	7.41	8.96	9.10	9.21
TOTAL LIABILITIES & REG. CAP.	100.00	100.00	100.00	100.00

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
FINANCIAL RATIOS - STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	1985	1986	1987	9/30/88
Interest Income	10.17	9.37	8.76	8.80
Interest Expense	8.07	6.93	6.13	6.33
Net Interest Inc. (Exp.)	2.10	2.44	2.62	2.48
Other Operating Income:				
Mortgage Loan Fees	0.32	0.39	0.32	0.14
Loan Servicing Fees	0.05	0.06	0.07	0.07
Other Loan Fees & Charges	0.09	0.10	0.09	0.07
Ser.Chgs. & Fees-Trans.Accts	0.05	0.06	0.07	0.07
Service Corps./Subsidiaries	0.09	0.10	0.05	0.07
Other	0.18	0.19	0.15	0.16
Total Oth. Operating Income	0.78	0.90	0.75	0.57
Operating Expense:				
Officers & Employees Comp.	0.77	0.83	0.84	0.82
Legal Expense	0.02	0.02	0.02	0.02
Office Occ. & Equip. Expense	0.34	0.36	0.38	0.37
Marketing Expense	0.08	0.08	0.09	0.08
Professional Services	0.03	0.04	0.04	0.04
Amortization of Goodwill	0.05	0.05	0.06	0.06
Other	0.53	0.55	0.54	0.48
Total Operating Expense	1.82	1.92	1.96	1.87
NET OPER. INCOME (DEFICIT)	1.06	1.42	1.41	1.18
Non-Operating Income:				
Profit on Sale of REO & Other	0.03	0.02	0.03	0.02
Profit on Sale of Investments	0.12	0.16	0.07	0.08
Profit on Sale of Loans	0.16	0.21	0.10	0.07
Amortized Deferred Gains	0.00	0.00	0.00	0.00
Other	0.06	0.05	0.09	0.05
Total Non-Operating Income	0.37	0.45	0.30	0.21
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	0.17	0.15
Loss on Sale of REO & Other	0.05	0.06	0.03	0.03
Loss on Sale of Investments	0.07	0.02	0.03	0.02
Loss on Sale of Loans	0.10	0.15	0.05	0.03
Amortized Deferred Losses	0.02	0.02	0.02	0.01
Other	0.04	0.06	0.10	0.02
Total Non-Operating Expense	0.27	0.31	0.40	0.27
INCOME (LOSS) BEF. TAXES & ADJ.	1.16	1.56	1.30	1.12
Income Taxes (Credits)	0.35	0.53	0.50	0.39
NET INCOME (LOSS) BEFORE ADJ.	0.80	1.03	0.80	0.74
Prior Period Adjustments	(0.04)	(0.02)	(0.00)	(0.03)
ADJUSTED NET INCOME (LOSS)	0.76	1.01	0.80	0.71

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
QUARTERLY STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	$ 5,348,817	$ 5,472,932	$ 5,669,330	$ 5,873,024
Interest Expense	3,821,214	3,946,307	4,047,389	4,232,143
Net Interest Inc. (Exp.)	1,527,603	1,526,625	1,621,941	1,640,881
Other Operating Income:				
Mortgage Loan Fees	169,368	85,404	95,287	81,707
Loan Servicing Fees	45,267	40,246	43,298	43,106
Other Loan Fees & Charges	48,407	39,650	41,468	48,468
Ser.Chgs. & Fees-Trans.Accts	41,831	43,518	44,737	48,263
Service Corps./Subsidiaries	27,835	56,575	49,340	24,194
Other	107,241	93,295	109,669	111,012
Total Oth. Operating Income	439,949	358,688	383,799	356,750
Operating Expense:				
Officers & Employees Comp.	524,626	519,006	521,484	537,607
Legal Expense	13,803	12,909	13,823	12,117
Office Occ. & Equip. Expense	231,722	236,854	238,099	245,551
Marketing Expense	53,962	50,065	56,697	50,177
Professional Services	29,171	24,503	27,882	29,558
Amortization of Goodwill	37,526	33,130	37,546	39,920
Other	329,872	303,702	311,335	310,139
Total Operating Expense	1,220,682	1,180,169	1,206,866	1,225,069
NET OPER. INCOME (DEFICIT)	746,870	705,144	798,874	772,562
Non-Operating Income:				
Profit on Sale of REO & Other	12,909	11,305	14,389	11,981
Profit on Sale of Investments	37,453	52,324	26,778	73,367
Profit on Sale of Loans	41,800	61,085	42,228	23,833
Amortized Deferred Gains	2,339	308	379	202
Other	45,864	26,827	19,634	47,248
Total Non-Operating Income	140,365	151,849	103,408	156,631
Non-Operating Expense:				
Provision for Losses on Assets	121,094	72,686	107,805	109,707
Loss on Sale of REO & Other	27,699	17,101	15,738	22,826
Loss on Sale of Investments	26,775	18,434	13,227	15,605
Loss on Sale of Loans	43,079	15,024	33,382	12,423
Amortized Deferred Losses	7,939	5,806	5,559	5,185
Other	26,511	20,449	18,531	9,248
Total Non-Operating Expense	253,097	149,500	194,242	174,994
INCOME (LOSS) BEF. TAXES & ADJ.	634,138	707,493	708,040	754,199
Income Taxes (Credits)	233,175	242,588	248,875	256,045
NET INCOME (LOSS) BEFORE ADJ.	405,473	469,112	459,165	498,154
Prior Period Adjustments	(1,069)	(40,387)	(26,200)	3,231
ADJUSTED NET INCOME (LOSS)	$ 404,404	$ 428,726	$ 432,966	$ 501,380

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THRIFTS W/GAAP CAP>6%, TAN. CAP>$0
FINANCIAL RATIOS - QUARTERLY STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	9.13	8.50	8.80	9.12
Interest Expense	6.52	6.13	6.28	6.57
Net Interest Inc. (Exp.)	2.61	2.37	2.52	2.55
Other Operating Income:				
Mortgage Loan Fees	0.29	0.13	0.15	0.13
Loan Servicing Fees	0.08	0.06	0.07	0.07
Other Loan Fees & Charges	0.08	0.06	0.06	0.08
Ser.Chgs. & Fees-Trans.Accts	0.07	0.07	0.07	0.07
Service Corps./Subsidiaries	0.05	0.09	0.08	0.04
Other	0.18	0.14	0.17	0.17
Total Other Oper. Income	0.75	0.56	0.60	0.55
Operating Expense:				
Officers & Employees Comp.	0.90	0.81	0.81	0.83
Legal Expense	0.02	0.02	0.02	0.02
Office Occ. & Equip. Expense	0.40	0.37	0.37	0.38
Marketing Expense	0.09	0.08	0.09	0.08
Professional Services	0.05	0.04	0.04	0.05
Amortization of Goodwill	0.06	0.05	0.06	0.06
Other	0.56	0.47	0.48	0.48
Total Operating Expense	2.08	1.83	1.87	1.90
NET OPER. INCOME (DEFICIT)	1.27	1.09	1.24	1.20
Non-Operating Income:				
Profit on Sale of REO & Other	0.02	0.02	0.02	0.02
Profit on Sale of Investments	0.06	0.08	0.04	0.11
Profit on Sale of Loans	0.07	0.09	0.07	0.04
Amortized Deferred Gains	0.00	0.00	0.00	0.00
Other	0.08	0.04	0.03	0.07
Total Non-Operating Income	0.24	0.24	0.16	0.24
Non-Operating Expense:				
Provision for Losses on Assets	0.21	0.11	0.17	0.17
Loss on Sale of REO & Other	0.05	0.03	0.02	0.04
Loss on Sale of Investments	0.05	0.03	0.02	0.02
Loss on Sale of Loans	0.07	0.02	0.05	0.02
Amortized Deferred Losses	0.01	0.01	0.01	0.01
Other	0.05	0.03	0.03	0.01
Total Non-Operating Expense	0.43	0.23	0.30	0.27
INCOME (LOSS) BEF. TAXES & ADJ.	1.08	1.10	1.10	1.17
Income Taxes (Credits)	0.40	0.38	0.39	0.40
NET INCOME (LOSS) BEFORE ADJ.	0.69	0.73	0.71	0.77
Prior Period Adjustments	(0.00)	(0.06)	(0.04)	0.01
ADJUSTED NET INCOME (LOSS)	0.69	0.67	0.67	0.78

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EXHIBIT V

SUMMARY OF THRIFTS WITH GAAP CAPITAL IN THE RANGE OF 1.5% TO 6%
WITH TANGIBLE CAPITAL GREATER THAN $0
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Cnv/Conv Lns/Assts	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
CT Totals, 13 Institutions	9,629,125	97	366,492	3.81	355,253	3.69	121,964	1.27	99.62	3.29	0.06	0.09	5,298	0.08	2,848	0.06	1.57
ME Totals, 3 Institutions	140,972	6	7,820	5.55	7,505	5.32	7,505	5.32	100.73	8.06	0.03	0.01	1,148	1.12	813	0.79	2.41
MA Totals, 11 Institutions	7,837,770	70	446,401	5.70	405,902	5.18	174,310	2.22	91.81	9.47	0.04	1.87	17,194	0.32	38,899	0.72	3.57
NH Totals, 1 Institution	133,160	1	8,798	6.61	7,201	5.41	7,201	5.41	103.72	4.59	0.03	0.15	1,334	1.40	745	0.78	1.78
RI Totals, 2 Institutions	268,293	2	8,799	3.28	8,458	3.15	4,464	1.66	74.45	4.69	0.07	0	(58)	(0.05)	(131)	(0.12)	0.85
VT Totals, 3 Institutions	555,017	13	31,396	5.66	30,534	5.50	27,735	5.00	98.54	11.22	0.08	0.50	2,383	0.60	1,679	0.42	2.81
NJ Totals, 57 Institutions	28,640,813	432	1,270,346	4.44	1,150,204	4.02	694,275	2.42	96.91	12.42	0.55	0.56	114,771	0.54	53,106	0.25	1.82
NY Totals, 29 Institutions	8,492,104	142	490,261	5.77	328,347	3.87	293,969	3.46	100.84	21.28	0.13	0.35	73,735	1.24	35,216	0.58	1.86
PR Totals, 6 Institutions	4,642,268	67	318,505	6.86	209,051	4.50	174,925	3.77	101.87	8.50	0.19	1.28	43,210	1.29	24,718	0.74	2.46
DE Totals, 3 Institutions	183,156	5	8,794	4.80	7,370	4.02	7,063	3.86	102.12	5.41	0	0.41	708	0.53	374	0.28	1.96
PA Totals, 63 Institutions	15,223,010	339	805,309	5.29	705,840	4.64	575,729	3.78	100.88	9.05	0.35	0.52	85,786	0.78	48,735	0.44	1.91
WV Totals, 7 Institutions	1,121,141	20	51,787	4.62	49,512	4.42	40,392	3.60	98.00	11.33	2.12	1.10	5,805	0.99	3,547	0.61	3.64
AL Totals, 12 Institutions	1,624,768	56	78,955	4.86	71,980	4.43	54,665	3.36	98.66	18.69	1.43	0.16	8,271	0.69	7,685	0.64	1.96
DC Totals, 4 Institutions	3,847,754	44	193,599	5.03	136,208	3.54	71,895	1.87	99.76	11.20	0.26	0.85	4,136	0.15	6,680	0.25	1.71
FL Totals, 63 Institutions	50,450,159	801	2,347,796	4.65	1,894,572	3.76	1,201,648	2.38	96.61	13.54	0.84	2.19	44,096	0.12	(2,796)	(0.01)	2.02
GA Totals, 22 Institutions	10,779,051	197	560,260	5.20	509,216	4.72	354,445	3.29	98.50	13.40	0.43	1.06	50,096	0.66	24,497	0.32	2.12
MD Totals, 30 Institutions	12,149,021	228	668,063	5.50	487,149	4.01	360,620	2.97	98.22	21.59	0.33	0.57	107,878	1.25	47,927	0.35	2.52
NC Totals, 39 Institutions	8,403,033	224	406,081	4.83	362,514	4.31	281,507	3.35	97.25	15.25	0.65	1.15	38,951	0.64	23,459	0.38	2.43
SC Totals, 18 Institutions	5,885,583	150	297,471	5.05	240,000	4.08	204,158	3.47	98.40	14.19	0.77	0.71	26,137	0.61	11,399	0.27	2.44
VA Totals, 35 Institutions	19,537,275	307	983,579	5.03	858,821	4.40	671,860	3.44	96.96	21.13	0.97	2.00	48,250	0.36	42,215	0.31	2.16
KY Totals, 26 Institutions	3,114,335	113	160,006	5.14	139,064	4.47	135,681	4.36	100.98	7.67	0.56	0.95	19,649	0.86	10,858	0.47	1.80
OH Totals, 66 Institutions	22,224,618	478	1,120,457	5.04	1,012,110	4.55	668,028	3.01	98.32	16.41	0.49	1.12	103,524	0.63	64,732	0.40	1.83
TN Totals, 25 Institutions	5,211,452	93	273,977	5.26	193,543	3.71	99,621	1.91	95.35	10.83	0.81	2.96	19,615	0.53	12,682	0.34	1.86
IN Totals, 36 Institutions	5,504,302	139	265,185	4.82	236,517	4.30	226,621	4.12	100.71	7.97	0.41	0.38	28,125	0.70	14,426	0.36	1.70

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SUMMARY OF THRIFTS WITH GAAP CAPITAL IN THE RANGE OF 1.5% TO 6%
WITH TANGIBLE CAPITAL GREATER THAN $0
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Conv/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
MI Totals, 27 Institutions	34,745,186	502	1,773,697	5.10	1,433,518	4.13	1,015,408	2.92	101.02	6.93	0.11	0.28	160,987	0.67	110,845	0.44	1.31
IL Totals, 82 Institutions	13,602,242	237	662,314	4.87	567,875	4.17	506,521	3.72	99.81	9.28	0.64	0.62	93,568	0.95	59,026	0.60	1.80
WI Totals, 18 Institutions	5,970,902	188	291,139	4.88	279,090	4.69	255,842	4.28	99.06	15.06	1.28	0.90	41,990	0.98	22,169	0.52	2.46
IA Totals, 23 Institutions	5,014,852	143	201,233	4.01	166,964	3.33	139,770	2.79	98.02	15.71	2.37	0.44	14,531	0.42	(19,356)	(0.56)	1.65
MN Totals, 17 Institutions	7,429,550	121	300,407	4.04	271,968	3.66	156,591	2.11	95.03	15.08	0.73	2.06	22,471	0.40	22,222	0.40	2.03
MO Totals, 30 Institutions	9,619,936	135	413,511	4.30	289,066	3.00	237,760	2.47	99.92	20.09	1.10	1.03	54,939	0.80	25,409	0.37	1.43
ND Totals, 3 Institutions	3,205,173	57	165,124	5.15	133,940	4.18	89,505	2.79	96.97	7.78	0.67	2.08	15,064	0.65	5,965	0.26	1.32
SD Totals, 7 Institutions	1,095,686	43	52,666	4.81	42,181	3.85	20,858	1.90	97.84	20.63	1.15	0.14	10,558	1.29	3,923	0.48	2.12
AR Totals, 16 Institutions	1,478,032	46	64,498	4.36	55,842	3.78	52,792	3.57	96.14	18.95	2.34	1.75	7,458	0.69	4,506	0.42	1.95
LA Totals, 29 Institutions	3,313,120	92	172,801	5.22	141,309	4.27	141,305	4.27	98.96	7.47	2.23	0.21	17,003	0.69	6,263	0.25	1.90
MS Totals, 15 Institutions	2,358,433	92	130,431	5.53	101,845	4.32	87,776	3.72	96.52	17.17	1.15	2.33	16,598	0.97	6,319	0.37	2.46
NM Totals, 8 Institutions	3,175,239	49	107,238	3.38	78,745	2.48	68,518	2.16	92.76	17.60	2.16	3.58	14,684	0.63	1,038	0.04	2.13
TX Totals, 62 Institutions	23,092,606	272	923,680	4.00	827,287	3.58	657,273	2.85	86.64	24.16	7.19	3.57	(2,433)	(0.02)	(31,040)	(0.22)	1.40
CO Totals, 9 Institutions	2,111,074	49	90,100	4.27	86,330	4.09	76,727	3.63	94.75	27.22	2.31	1.92	1,299	0.06	(3,126)	(0.20)	2.44
KS Totals, 22 Institutions	15,013,555	166	703,306	4.69	646,438	4.31	603,156	4.02	98.23	10.92	0.80	2.85	20,389	0.19	74,330	0.71	1.35
NE Totals, 7 Institutions	8,073,620	149	272,042	3.37	256,846	3.18	50,214	0.62	93.66	11.06	1.05	2.66	12,384	0.21	8,368	0.14	1.58
OK Totals, 12 Institutions	3,442,077	88	127,264	3.70	124,445	3.62	123,840	3.60	97.24	13.29	2.32	1.21	(1,960)	(0.08)	(10,759)	(0.76)	1.77
AZ Totals, 5 Institutions	14,308,031	131	589,125	4.06	434,591	3.00	214,672	1.48	92.99	20.00	2.06	2.47	(100,219)	(0.94)	(35,977)	(0.34)	2.00
CA Totals, 112 Institutions	262,782,022	2,396	13,091,692	4.98	11,730,740	4.46	8,139,319	3.10	97.82	21.12	0.49	2.25	1,169,579	0.63	761,279	0.41	1.66
NV Totals, 4 Institutions	5,049,877	82	277,930	5.50	271,902	5.38	130,614	2.59	97.48	14.54	1.01	0.18	44,019	1.22	25,375	0.70	1.62
AK Totals, 1 Institution	125,120	5	6,444	5.15	5,236	4.18	5,236	4.18	96.76	28.37	4.91	0.00	424	0.44	60	0.06	3.24
HI Totals, 3 Institutions	1,606,093	42	51,578	3.21	47,916	2.98	47,916	2.98	97.62	7.82	0.96	1.95	8,467	0.73	5,106	0.44	2.25
ID Totals, 4 Institutions	624,164	22	45,263	7.25	23,272	3.73	23,272	3.73	99.35	7.46	0.50	0.00	3,760	0.81	(19)	0.00	1.65
MT Totals, 4 Institutions	494,409	23	25,456	5.15	21,149	4.28	20,997	4.25	98.43	9.06	0.95	0.11	2,826	0.75	379	0.10	2.48

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SUMMARY OF THRIFTS WITH GAAP CAPITAL IN THE RANGE OF 1.5% TO 6%
WITH TANGIBLE CAPITAL GREATER THAN $0
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Branchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
OR Totals, 5 Institutions	560,547	22	30,091	5.37	25,757	4.26	23,506	4.19	100.28	15.61	0.49	1.01	3,671	0.90	2,281	0.56	2.07
UT Totals, 5 Institutions	1,012,006	29	43,566	4.30	39,379	3.89	31,987	3.15	95.18	8.56	0.00	1.64	11	0.00	4	0.00	2.09
WA Totals, 19 Institutions	10,100,310	190	597,208	5.87	443,910	4.36	334,952	3.29	99.39	20.09	0.81	0.59	29,303	0.41	21,551	0.30	1.97
WY Totals, 2 Institutions	63,010	3	1,822	2.89	1,606	2.55	1,606	2.55	89.87	5.12	6.74	0.37	18	0.04	(399)	(0.83)	2.79
Grand Totals, 1125 Institutions	665,345,796	9,358	32,381,856	4.87	27,954,818	4.20	19,717,790	2.96	97.16	17.08	0.87	1.74	2,521,511	0.53	1,532,035	0.32	1.80

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Docket
Charter
District
Branches 9,358

THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0

EXHIBIT VI

FINANCIAL HIGHLIGHTS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Total Assets	$ 457,052,379	$ 522,021,961	$ 593,927,512	$ 665,345,796
% Change in Assets	13.48%	14.21%	13.77%	12.02%
Regulatory Capital	19,844,666	26,563,563	29,984,994	32,381,836
Estimated GAAP Capital	16,184,390	22,107,247	25,672,909	27,954,818
Tangible Capital	9,352,693	14,797,059	17,838,280	19,717,790
Regulatory Capital/Total Assets	4.34%	5.09%	5.05%	4.87%
Est. GAAP Capital/Total Assets	3.54%	4.23%	4.32%	4.20%
Tangible Capital/Total Assets	2.05%	2.83%	3.00%	2.96%
Net Income (Loss)	2,978,504	4,110,225	2,744,731	1,532,035
Return on Average Assets	0.69%	0.84%	0.49%	0.32%
Return on Avg. Regulatory Cap.	16.87%	17.71%	9.71%	6.55%
Yield on Loans	11.41%	10.60%	9.63%	9.64%
Yield on Investments	9.28%	7.99%	7.99%	8.58%
Yield on Earning Assets	11.11%	10.24%	9.40%	9.50%
Cost of Savings	9.02%	7.79%	6.85%	7.23%
Cost of Borrowings	9.45%	8.81%	8.15%	8.12%
Cost of Funds	9.10%	7.98%	7.13%	7.44%
Yield/Cost Spread	2.01%	2.26%	2.27%	2.06%
Amt.Elig. for Reg. Liquidity	43,006,753	52,583,899	43,213,207	43,706,351
Amt.Elig. for Reg.Liq./Tot.Assets	9.41%	10.07%	7.28%	6.57%
Int.Earn.Asst./Int.Bear.Liab.	96.01%	97.19%	97.22%	97.16%
Loans & Participations Purchased	21,474,372	26,062,923	26,238,002	21,781,539
Loans & Participations Sold	43,198,248	71,648,030	65,877,284	47,498,302
Mortg. Loans Serviced for Others	105,749,135	145,929,159	167,328,756	181,842,967
Mortg. Loans Serviced by Others	47,904,350	47,891,215	50,291,395	53,577,772
Broker Originated Deposits	23,160,949	24,826,575	36,655,024	42,812,390
Cash Div. on Preferred Stock	21,788	29,129	69,157	53,538
Cash Div. on Permanent Stock	196,204	362,349	636,643	300,745
Cash Div. on Other Cap. Inst.	3,887	3,979	64,858	2,976
Non 1-4 Con./Conv.Lns./Tot.Asst	17.45%	17.99%	17.38%	17.08%
Balloon & Adj. Rate Loans	139,867,007	173,711,428	223,785,589	274,142,623
Ser.Corp.Inc./Inv.in Ser.Corp.	9.57%	11.75%	7.55%	5.59%
OTHER INFORMATION				
Annual Closing Date	N/A	N/A	N/A	N/A
No. of Wholly-Owned Ser. Corps.	1,370	1,521	0	N/A
No. of Deposit Accounts	45,516,009	47,288,209	49,569,360	52,099,643

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
BALANCE SHEETS
(Dollars in Thousands)

ASSETS	1985	1986	1987	6/30/88
Construction Loans On:				
1-4 Dwelling Units	$ N/A	$ N/A	$ 10,512,648	$ 12,373,640
5 or More Dwelling Units	N/A	N/A	6,179,573	6,322,467
Nonresidential	N/A	N/A	7,753,770	8,218,957
Permanent Mortgages On:				
1-4 Dwelling Units	198,916,338	206,700,412	227,516,198	258,509,819
5 or More Dwelling Units	33,541,473	39,924,585	38,807,708	41,725,944
Nonresidential (Except Land)	38,819,713	44,635,487	40,621,833	45,511,756
Dev. Bldg. Lots, Land, Etc.	7,372,778	9,353,210	9,834,501	11,855,964
Mortgage Backed Securities	55,110,394	72,132,807	101,232,043	108,356,559
Accrued Interest Receivable	3,422,840	3,672,066	4,120,967	4,279,436
Other Mortgage Receivables	9,005,421	10,252,987	649,473	1,145,320
Loans in Process	(9,693,686)	(10,730,512)	(11,221,243)	(12,143,812)
Unearned Disc. & Def. Loan Fees	(3,944,734)	(3,277,521)	(3,496,691)	(3,547,147)
Specific Reserves & Val. Allow.	(695,136)	(1,286,526)	(1,669,395)	(1,771,604)
Net Mortgage Loans	331,855,396	371,376,979	430,841,466	480,837,307
Commercial Loans	6,479,820	11,579,423	11,517,084	13,315,895
Consumer Loans	18,685,805	22,305,572	26,253,739	29,345,234
Financing Leases	234,215	196,891	460,498	983,510
Accrued Interest Receivable	312,981	354,989	378,029	446,738
Loans in Process	(408,224)	(365,283)	(495,132)	(632,123)
Unearned Disc. & Def. Loan Fees	(156,545)	(253,472)	(294,283)	(264,071)
Specific Reserves & Val. Allow.	(174,418)	(301,336)	(475,323)	(545,338)
Net Nonmortgage Loans	24,973,642	33,516,772	37,344,614	42,649,851
Repossessed Assets	2,078,709	3,137,688	4,492,763	6,438,416
Valuation Allowances	(204,253)	(399,536)	(631,951)	(677,913)
Net Repossessed Assets	1,874,456	2,738,152	3,860,812	5,760,503
Real Estate Held For Dev., Etc.	1,778,213	2,466,932	2,196,191	2,722,675
Valuation Allowances	(36,375)	(60,699)	(87,517)	(104,303)
Net Real Estate Held for Dev.	1,741,838	2,406,233	2,108,674	2,618,372
Cash & Demand Deposits	5,945,347	8,072,505	7,964,880	8,937,715
U.S. Govt. & Agency Securities	17,483,665	22,243,906	25,383,263	21,158,869
Equity Sec., Except FHLB/FHLMC	431,970	610,287	675,336	2,112,268
Other Investments	38,186,466	44,938,902	45,881,886	56,837,231
Accrued Interest Receivable	742,970	749,028	976,783	1,101,859
Valuation Allowances	(27,085)	(87,653)	(185,683)	(218,072)
Net Cash & Investment Sec.	62,763,333	76,526,975	80,696,465	89,929,870
Net Fixed Assets	5,783,247	6,872,428	7,700,349	8,386,336
Investment in Ser. Corps./Subs.	8,855,363	8,101,397	9,970,054	11,564,555
Deferred Net Losses (Gains)	2,112,353	1,822,289	1,549,173	1,404,772
Intangible Assets	6,831,697	7,310,188	7,834,629	8,237,028
Other Assets	10,260,966	11,350,507	12,021,266	13,957,196
TOTAL ASSETS	$ 457,052,379	$ 522,021,961	$ 593,927,512	$ 665,345,796

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
BALANCE SHEETS
(Dollars in Thousands)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	$ 252,169,381	$ 268,015,378	$ 304,073,380	$ 348,903,393
Transaction Accounts	15,796,023	24,343,497	27,714,482	31,081,358
Money Market Deposit Accounts	54,749,576	60,561,118	53,930,418	51,923,805
Passbook Accounts	25,084,042	33,925,253	39,033,316	40,449,736
Total Savings Deposits	347,799,022	386,845,246	424,751,596	472,358,292
FHLB Advances	39,903,481	47,638,325	58,243,094	64,156,570
Repurchase Agreements	25,022,291	29,991,861	43,098,625	48,640,807
Commercial Paper Issued	279,087	421,482	1,734,460	2,249,662
Sub.Deb. not Qual. as Reg.Cap.	388,228	176,220	124,374	261,602
Mortgage-Backed Bonds Issued	5,389,906	7,178,841	9,672,191	11,431,010
Other Borrowings	8,307,980	11,570,073	15,474,412	19,606,988
Other Liabilities	10,117,658	11,636,348	10,843,667	14,259,023
TOTAL LIABILITIES	437,207,713	495,458,397	563,942,514	632,963,962
REGULATORY CAPITAL				
Preferred Stock	119,055	137,364	399,750	711,203
Permanent Stock	496,935	600,737	719,095	810,286
Contributed Capital	3,758,241	6,219,445	6,992,524	7,590,426
Qualifying Mutual Cap. Cert.	0	1,645	0	8,538
Qualifying Subordinated Deb.	849,156	1,582,239	1,892,837	2,189,043
Appraised Equity Capital	717,422	1,015,353	948,439	923,348
Net Worth & Income Cap. Cert.	143,507	141,843	44,185	34,205
Retained Earnings (Deficit)	13,760,352	16,864,939	18,988,169	20,114,797
TOTAL REGULATORY CAPITAL	19,844,666	26,563,563	29,984,994	32,381,836
TOTAL LIAB. & REG. CAPITAL	$ 457,052,382	$ 522,021,961	$ 593,927,509	$ 665,345,794

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 42,959,331	$ 45,060,738	$ 47,223,748	$ 40,473,531
Interest Expense	36,674,887	36,279,069	36,700,559	32,492,942
Net Interest Inc. (Exp.)	6,284,444	8,781,669	10,523,189	7,980,589
Other Operating Income:				
Mortgage Loan Fees	1,536,221	1,828,970	1,737,673	635,394
Loan Servicing Fees	297,295	431,863	582,631	465,448
Other Loan Fees & Charges	415,072	531,296	539,024	395,455
Ser.Chgs. & Fees - Trans.Accts.	256,457	327,575	401,946	359,802
Service Corps./Subsidiaries	744,556	995,976	682,177	451,700
Other	809,997	1,399,878	834,719	741,418
Total Oth. Operating Income	4,059,598	5,515,558	4,778,170	3,049,217
Operating Expense:				
Officers & Employees Comp.	3,092,897	3,741,399	4,417,326	3,465,305
Legal Expense	84,541	112,071	147,683	130,264
Office Occ. & Equip. Expense	1,499,203	1,793,794	2,074,006	1,731,026
Marketing Expense	353,385	394,666	449,833	344,539
Professional Services	154,372	192,291	244,623	184,220
Amortization of Goodwill	272,503	308,795	352,135	286,467
Other	2,330,328	2,833,584	3,162,025	2,366,474
Total Operating Expense	7,787,229	9,376,600	10,847,631	8,508,295
NET OPER. INCOME (DEFICIT)	2,556,813	4,920,627	4,453,728	2,521,511
Non-Operating Income:				
Profit on Sale of REO & Other	219,928	232,269	284,052	190,473
Profit on Sale of Investments	951,527	1,197,750	706,738	620,883
Profit on Sale of Loans	1,529,149	1,896,047	1,354,696	648,049
Amortized Deferred Gains	37,451	31,288	24,658	4,220
Other	201,548	223,316	475,085	358,900
Total Non-Operating Income	2,939,603	3,580,670	2,845,229	1,822,525
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	1,389,649	1,108,179
Loss on Sale of REO & Other	223,987	377,985	237,792	148,656
Loss on Sale of Investments	156,614	305,927	327,059	130,440
Loss on Sale of Loans	534,815	1,021,923	351,554	143,254
Amortized Deferred Losses	123,375	136,960	128,306	82,488
Other	201,480	478,993	544,491	145,339
Total Non-Operating Expense	1,240,271	2,321,788	2,978,851	1,758,356
INCOME (LOSS) BEF. TAXES & ADJ.	4,256,145	6,179,509	4,320,106	2,585,680
Income Taxes (Credits)	1,214,142	1,989,830	1,538,587	911,315
NET INCOME (LOSS) BEFORE ADJ.	3,041,595	4,189,615	2,825,776	1,700,695
Prior Period Adjustments	(63,101)	(79,387)	(81,038)	(168,663)
ADJUSTED NET INCOME (LOSS)	$ 2,978,504	$ 4,110,225	$ 2,744,731	$ 1,532,035

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	N/A	N/A	1.77	1.86
5 or More Dwelling Units	N/A	N/A	1.04	0.95
Nonresidential	N/A	N/A	1.31	1.24
Permanent Mortgages On:				
1-4 Dwelling Units	43.52	39.60	38.31	38.85
5 or More Dwelling Units	7.34	7.65	6.53	6.27
Nonresidential (Except Land)	8.49	8.55	6.84	6.84
Dev. Bldg. Lots, Land, Etc.	1.61	1.79	1.66	1.78
Mortgage Backed Securities	12.06	13.82	17.04	16.29
Accrued Interest Receivable	0.75	0.70	0.69	0.64
Other Mortgage Receivables	1.97	1.96	0.11	0.17
Loans in Process	(2.12)	(2.06)	(1.89)	(1.83)
Unearned Disc. & Def. Loan Fees	(0.86)	(0.63)	(0.59)	(0.53)
Specific Reserves & Val. Allow.	(0.15)	(0.25)	(0.28)	(0.27)
Net Mortgage Loans	72.61	71.14	72.54	72.27
Commercial Loans	1.42	2.22	1.94	2.00
Consumer Loans	4.09	4.27	4.42	4.41
Financing Leases	0.05	0.04	0.08	0.15
Accrued Interest Receivable	0.07	0.07	0.06	0.07
Loans in Process	(0.09)	(0.07)	(0.08)	(0.10)
Unearned Disc. & Def. Loan Fees	(0.03)	(0.05)	(0.05)	(0.04)
Specific Reserves & Val. Allow.	(0.04)	(0.06)	(0.08)	(0.08)
Net Nonmortgage Loans	5.46	6.42	6.29	6.41
Repossessed Assets	0.45	0.60	0.76	0.97
Valuation Allowances	(0.04)	(0.08)	(0.11)	(0.10)
Net Repossessed Assets	0.41	0.52	0.65	0.87
Real Estate Held For Dev., Etc.	0.39	0.47	0.37	0.41
Valuation Allowances	(0.01)	(0.01)	(0.01)	(0.02)
Net Real Estate Held for Dev.	0.38	0.46	0.36	0.39
Cash & Demand Deposits	1.30	1.55	1.34	1.34
U.S. Govt. & Agency Securities	3.83	4.26	4.27	3.18
Equity Sec., Except FHLB/FHLMC	0.09	0.12	0.11	0.32
Other Investments	8.35	8.61	7.73	8.54
Accrued Interest Receivable	0.16	0.14	0.16	0.17
Valuation Allowances	(0.01)	(0.02)	(0.03)	(0.03)
Net Cash & Investment Sec.	13.73	14.66	13.59	13.52
Net Fixed Assets	1.27	1.32	1.30	1.26
Investment in Ser. Corps./Subs.	1.94	1.55	1.68	1.74
Deferred Net Losses (Gains)	0.46	0.35	0.26	0.21
Intangible Assets	1.49	1.40	1.32	1.24
Other	2.25	2.17	2.02	2.10
TOTAL ASSETS	100.00	100.00	100.00	100.00

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	55.17	51.34	51.20	52.44
Transaction Accounts	3.46	4.66	4.67	4.67
Money Market Deposit Accounts	11.98	11.60	9.08	7.80
Passbook Accounts	5.49	6.50	6.57	6.08
Total Savings Deposits	76.10	74.11	71.52	70.99
FHLB Advances	8.73	9.13	9.81	9.64
Repurchase Agreements	5.47	5.75	7.26	7.31
Commercial Paper Issued	0.06	0.08	0.29	0.34
Sub. Deb. not Qual. as Reg. Cap.	0.08	0.03	0.02	0.04
Mortgage-Backed Bonds Issued	1.18	1.38	1.63	1.72
Other Borrowings	1.82	2.22	2.61	2.95
Other Liabilities	2.21	2.23	1.83	2.14
TOTAL LIABILITIES	95.66	94.91	94.95	95.13
REGULATORY CAPITAL				
Preferred Stock	0.03	0.03	0.07	0.11
Permanent Stock	0.11	0.12	0.12	0.12
Contributed Capital	0.82	1.19	1.18	1.14
Qualifying Mutual Cap. Cert.	0.00	0.00	0.00	0.00
Qualifying Subordinated Deb.	0.19	0.30	0.32	0.33
Appraised Equity Capital	0.16	0.19	0.16	0.14
Net Worth & Income Cap. Cert.	0.03	0.03	0.01	0.01
Retained Earnings (Deficit)	3.01	3.23	3.20	3.02
TOTAL REGULATORY CAPITAL	4.34	5.09	5.05	4.87
TOTAL LIABILITIES & REG. CAP.	100.00	100.00	100.00	100.00

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
FINANCIAL RATIOS - STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	1985	1986	1987	9/30/88
Interest Income	9.99	9.20	8.46	8.57
Interest Expense	8.53	7.41	6.58	6.88
Net Interest Inc. (Exp.)	1.46	1.79	1.89	1.69
Other Operating Income:				
Mortgage Loan Fees	0.36	0.37	0.31	0.13
Loan Servicing Fees	0.07	0.09	0.10	0.10
Other Loan Fees & Charges	0.10	0.11	0.10	0.08
Ser.Chgs. & Fees-Trans.Accts	0.06	0.07	0.07	0.08
Service Corps./Subsidiaries	0.17	0.20	0.12	0.10
Other	0.19	0.29	0.15	0.16
Total Oth. Operating Income	0.94	1.13	0.86	0.65
Operating Expense:				
Officers & Employees Comp.	0.72	0.76	0.79	0.73
Legal Expense	0.02	0.02	0.03	0.03
Office Occ. & Equip. Expense	0.35	0.37	0.37	0.37
Marketing Expense	0.08	0.08	0.08	0.07
Professional Services	0.04	0.04	0.04	0.04
Amortization of Goodwill	0.06	0.06	0.06	0.06
Other	0.54	0.58	0.57	0.50
Total Operating Expense	1.81	1.92	1.94	1.80
NET OPER. INCOME (DEFICIT)	0.59	1.01	0.80	0.53
Non-Operating Income:				
Profit on Sale of REO & Other	0.05	0.05	0.05	0.04
Profit on Sale of Investments	0.22	0.24	0.13	0.13
Profit on Sale of Loans	0.36	0.39	0.24	0.14
Amortized Deferred Gains	0.01	0.01	0.00	0.00
Other	0.05	0.05	0.09	0.08
Total Non-Operating Income	0.68	0.73	0.51	0.39
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	0.25	0.23
Loss on Sale of REO & Other	0.05	0.08	0.04	0.03
Loss on Sale of Investments	0.04	0.06	0.06	0.03
Loss on Sale of Loans	0.12	0.21	0.06	0.03
Amortized Deferred Losses	0.03	0.03	0.02	0.02
Other	0.05	0.10	0.10	0.03
Total Non-Operating Expense	0.29	0.47	0.53	0.37
INCOME (LOSS) BEF. TAXES & ADJ.	0.99	1.26	0.77	0.55
Income Taxes (Credits)	0.28	0.41	0.28	0.19
NET INCOME (LOSS) BEFORE ADJ.	0.71	0.86	0.51	0.36
Prior Period Adjustments	(0.01)	(0.02)	(0.01)	(0.04)
ADJUSTED NET INCOME (LOSS)	0.69	0.84	0.49	0.32

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
QUARTERLY STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	$ 12,611,663	$ 12,927,294	$ 13,387,745	$ 14,158,492
Interest Expense	10,068,371	10,381,410	10,673,163	11,438,369
Net Interest Inc. (Exp.)	2,543,292	2,545,884	2,714,582	2,720,123
Other Operating Income:				
Mortgage Loan Fees	425,042	194,772	249,463	191,159
Loan Servicing Fees	152,777	147,332	159,404	158,712
Other Loan Fees & Charges	135,006	120,459	131,449	143,547
Ser.Chgs. & Fees-Trans.Accts	110,919	113,462	119,264	127,076
Service Corps./Subsidiaries	103,887	73,132	238,568	140,000
Other	182,380	274,090	202,238	265,090
Total Oth. Operating Income	1,110,011	923,247	1,100,386	1,025,584
Operating Expense:				
Officers & Employees Comp.	1,160,016	1,141,828	1,146,658	1,176,819
Legal Expense	45,135	37,820	48,235	44,209
Office Occ. & Equip. Expense	554,359	561,140	576,305	593,581
Marketing Expense	121,849	114,046	119,044	111,449
Professional Services	63,125	57,845	64,793	61,582
Amortization of Goodwill	91,724	93,641	94,876	97,950
Other	877,647	768,240	786,931	811,303
Total Operating Expense	2,913,855	2,774,560	2,836,842	2,896,893
NET OPER. INCOME (DEFICIT)	739,448	694,571	978,126	848,814
Non-Operating Income:				
Profit on Sale of REO & Other	97,928	53,797	67,454	69,222
Profit on Sale of Investments	189,465	173,173	178,324	269,386
Profit on Sale of Loans	161,032	285,297	201,898	160,854
Amortized Deferred Gains	1,937	1,412	1,497	1,311
Other	202,955	75,244	133,074	150,582
Total Non-Operating Income	653,317	588,923	582,247	651,355
Non-Operating Expense:				
Provision for Losses on Assets	474,385	318,553	391,018	398,608
Loss on Sale of REO & Other	65,029	50,418	47,260	50,978
Loss on Sale of Investments	125,246	43,524	47,333	39,583
Loss on Sale of Loans	77,406	54,856	44,948	43,450
Amortized Deferred Losses	30,612	26,359	28,359	27,770
Other	50,262	31,179	61,861	52,299
Total Non-Operating Expense	822,940	524,889	620,779	612,688
INCOME (LOSS) BEF. TAXES & ADJ.	569,825	758,605	939,594	887,481
Income Taxes (Credits)	233,872	272,980	325,680	312,642
NET INCOME (LOSS) BEFORE ADJ.	360,053	511,954	613,914	574,827
Prior Period Adjustments	(65,471)	(80,060)	2,012	(90,615)
ADJUSTED NET INCOME (LOSS)	$ 294,582	$ 431,895	$ 615,927	$ 484,213

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THRIFTS W/GAAP CAP 1.5-6% TAN CAP>0
FINANCIAL RATIOS - QUARTERLY STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	9.04	8.21	8.51	8.99
Interest Expense	7.22	6.60	6.78	7.27
Net Interest Inc. (Exp.)	1.82	1.62	1.72	1.73
Other Operating Income:				
Mortgage Loan Fees	0.30	0.12	0.16	0.12
Loan Servicing Fees	0.11	0.09	0.10	0.10
Other Loan Fees & Charges	0.10	0.08	0.08	0.09
Ser.Chgs. & Fees-Trans.Accts	0.08	0.07	0.08	0.08
Service Corps./Subsidiaries	0.07	0.05	0.15	0.09
Other	0.13	0.17	0.13	0.17
Total Other Oper. Income	0.80	0.59	0.70	0.65
Operating Expense:				
Officers & Employees Comp.	0.83	0.73	0.73	0.75
Legal Expense	0.03	0.02	0.03	0.03
Office Occ. & Equip. Expense	0.40	0.36	0.37	0.38
Marketing Expense	0.09	0.07	0.08	0.07
Professional Services	0.05	0.04	0.04	0.04
Amortization of Goodwill	0.07	0.06	0.06	0.06
Other	0.63	0.49	0.50	0.52
Total Operating Expense	2.09	1.76	1.80	1.84
NET OPER. INCOME (DEFICIT)	0.53	0.44	0.62	0.54
Non-Operating Income:				
Profit on Sale of REO & Other	0.07	0.03	0.04	0.04
Profit on Sale of Investments	0.14	0.11	0.11	0.17
Profit on Sale of Loans	0.12	0.18	0.13	0.10
Amortized Deferred Gains	0.00	0.00	0.00	0.00
Other	0.15	0.05	0.08	0.10
Total Non-Operating Income	0.47	0.37	0.37	0.41
Non-Operating Expense:				
Provision for Losses on Assets	0.34	0.20	0.25	0.25
Loss on Sale of REO & Other	0.05	0.03	0.03	0.03
Loss on Sale of Investments	0.09	0.03	0.03	0.03
Loss on Sale of Loans	0.06	0.03	0.03	0.03
Amortized Deferred Losses	0.02	0.02	0.02	0.02
Other	0.04	0.02	0.04	0.03
Total Non-Operating Expense	0.59	0.33	0.39	0.39
INCOME (LOSS) BEF. TAXES & ADJ.	0.41	0.48	0.60	0.56
Income Taxes (Credits)	0.17	0.17	0.21	0.20
NET INCOME (LOSS) BEFORE ADJ.	0.26	0.33	0.39	0.37
Prior Period Adjustments	(0.05)	(0.05)	0.00	(0.06)
ADJUSTED NET INCOME (LOSS)	0.21	0.27	0.39	0.31

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EXHIBIT VII

SUMMARY OF THRIFTS WITH GAAP CAPITAL IN THE RANGE OF 0% TO 1.5%
WITH TANGIBLE CAPITAL GREATER THAN 90
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Com/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
CT Totals, 1 Institution	68,852	1	1,739	2.53	455	0.66	455	0.66	95.56	7.73	0	2.30	(209)	(0.43)	(385)	(0.79)	1.60
MA Totals, 1 Institution	202,085	3	11,227	5.56	1,928	0.95	1,928	0.95	96.40	5.61	0.21	0.01	1,637	1.11	1,575	1.06	2.25
NJ Totals, 6 Institutions	1,610,066	22	46,588	2.89	10,843	0.67	9,281	0.58	94.52	7.87	0.82	1.99	(1,303)	(0.13)	(7,334)	(0.63)	1.96
NY Totals, 4 Institutions	2,087,544	35	84,917	4.07	26,159	1.25	26,159	1.25	95.60	20.77	0.09	(0.06)	8,590	0.50	6,345	0.63	1.50
AL Totals, 2 Institutions	89,720	3	2,976	3.32	864	0.96	864	0.96	93.63	9.95	2.91	0.10	(53)	(0.08)	(405)	(0.72)	2.25
FL Totals, 5 Institutions	4,202,740	56	103,924	2.47	42,644	1.01	42,576	1.01	95.73	11.25	1.42	1.51	(862)	(0.03)	1,259	0.04	1.76
GA Totals, 3 Institutions	381,827	6	14,242	3.73	2,299	0.60	2,299	0.60	96.31	13.03	0.56	0.67	2,029	0.73	937	0.34	2.06
MD Totals, 3 Institutions	283,779	16	12,704	4.48	2,854	1.01	2,854	1.01	96.86	8.40	0.15	0.04	686	0.35	398	0.20	2.23
NC Totals, 1 Institution	21,988	1	602	2.74	293	1.33	293	1.33	94.20	12.93	0.95	0.61	144	0.87	92	0.55	2.96
KY Totals, 2 Institutions	107,084	3	3,607	3.37	1,040	0.97	1,040	0.97	95.79	4.68	2.93	0.31	94	0.11	(1,254)	(1.52)	1.90
OH Totals, 4 Institutions	330,312	7	10,573	3.20	3,724	1.13	3,724	1.13	96.30	13.41	0.99	0.09	1,069	0.76	694	0.28	1.91
TN Totals, 3 Institutions	124,593	6	3,624	2.91	1,399	1.12	878	0.70	96.67	5.19	1.08	0.04	(370)	(0.30)	(1,206)	(1.32)	2.90
MI Totals, 1 Institution	212,235	6	7,185	3.39	2,726	1.28	2,726	1.28	100.25	20.02	0.00	(0.01)	1,088	0.72	358	0.37	2.76
IL Totals, 14 Institutions	3,561,121	52	89,480	2.51	24,032	0.67	24,032	0.67	95.25	12.38	1.51	1.12	4,313	0.17	(2,219)	(0.09)	2.09
WI Totals, 1 Institution	336,773	12	11,462	3.40	3,369	1.00	3,369	1.00	97.68	30.51	0.30	2.27	(542)	(0.21)	42	0.02	2.27
IA Totals, 6 Institutions	1,479,649	53	37,003	2.50	13,236	0.89	10,560	0.71	94.46	21.05	2.17	0.53	3,985	0.36	(2,042)	(0.19)	1.67
MN Totals, 2 Institutions	324,394	8	6,762	2.08	1,455	0.45	1,455	0.45	96.07	19.22	2.08	0.08	451	0.19	(1,263)	(0.52)	1.99
MO Totals, 3 Institutions	197,383	9	7,387	3.74	1,349	0.68	1,349	0.68	97.82	11.46	0.46	0.17	1,393	0.95	829	0.55	1.80
AR Totals, 1 Institution	32,776	1	1,065	3.25	295	0.90	295	0.90	95.92	14.51	0.45	2.50	170	0.69	225	0.92	1.36
LA Totals, 8 Institutions	549,914	19	15,862	2.88	3,976	0.72	3,976	0.72	90.33	10.33	5.69	0.12	(8)	0.00	(2,520)	(0.61)	2.19
MS Totals, 3 Institutions	248,021	4	6,083	2.45	2,967	1.20	2,967	1.20	90.17	29.45	4.51	1.81	(552)	(0.31)	(799)	(0.45)	2.03
TX Totals, 13 Institutions	13,976,309	204	204,327	1.46	39,340	0.28	20,055	0.14	72.30	24.55	17.09	1.11	(35,182)	(0.51)	(56,352)	(0.81)	1.16
CO Totals, 3 Institutions	1,192,084	17	14,464	1.21	14,174	1.19	14,174	1.19	87.44	60.09	11.33	0.62	(18,080)	(2.09)	(32,706)	(3.67)	1.06
OK Totals, 7 Institutions	2,282,170	57	5,397	0.24	5,266	0.23	5,266	0.23	93.18	15.76	6.54	0.33	(3,090)	(0.36)	(21,659)	(2.14)	1.17

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SUMMARY OF THRIFTS WITH GAAP CAPITAL IN THE RANGE OF 0% TO 1.5%
WITH TANGIBLE CAPITAL GREATER THAN 00
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Inc.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
CA Totals, 8 Institutions	49,539,797	302	740,906	1.50	381,051	0.77	330,542	0.68	90.82	15.06	4.41	1.59	(44,317)	(0.16)	(24,479)	(0.09)	0.88
UT Totals, 1 Institution	17,877	3	246	1.38	246	1.38	246	1.38	86.76	12.04	10.98	0.01	(346)	(2.44)	(252)	(1.77)	5.20
WY Totals, 1 Institution	15,246	2	844	5.54	170	1.12	170	1.12	86.30	22.16	6.23	0	95	0.84	(77)	(0.68)	4.16
Grand Totals, 107 Institutions	83,476,270	908	1,445,194	1.73	588,954	0.71	521,331	0.62	88.60	17.10	6.09	1.34	(81,739)	(0.17)	(142,156)	(0.30)	1.18

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Docket
Charter
District
Branches 908

THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0

EXHIBIT VIII

FINANCIAL HIGHLIGHTS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Total Assets	$ 62,491,228	$ 73,258,664	$ 78,679,315	$ 83,476,270
% Change in Assets	4.43%	17.23%	7.40%	6.10%
Regulatory Capital	1,608,214	2,040,863	887,121	1,445,194
Estimated GAAP Capital	1,003,063	1,186,373	(63,335)	588,954
Tangible Capital	(215,248)	2,317	(1,197,564)	521,531
Regulatory Capital/Total Assets	2.57%	2.79%	1.13%	1.73%
Est. GAAP Capital/Total Assets	1.61%	1.62%	(0.08%)	0.71%
Tangible Capital/Total Assets	(0.34%)	0.00%	(1.52%)	0.62%
Net Income (Loss)	230,142	167,608	(1,260,563)	(1,756,648)
Return on Average Assets	0.38%	0.25%	(1.66%)	(2.89%)
Return on Avg. Regulatory Cap.	15.76%	9.19%	(86.10%)	(200.85%)
Yield on Loans	11.60%	10.11%	9.26%	9.24%
Yield on Investments	9.05%	7.88%	8.02%	9.33%
Yield on Earning Assets	11.31%	9.88%	9.13%	9.25%
Cost of Savings	9.40%	8.18%	7.11%	7.23%
Cost of Borrowings	9.36%	7.45%	7.96%	8.55%
Cost of Funds	9.39%	7.96%	7.42%	7.63%
Yield/Cost Spread	1.92%	1.92%	1.71%	1.62%
Amt.Elig. for Reg. Liquidity	5,760,903	4,691,229	4,880,170	4,177,579
Amt.Elig. for Reg.Liq./Tot.Assets	9.22%	6.40%	6.20%	5.00%
Int.Earn.Asst./Int.Bear.Liab.	91.44%	93.16%	90.87%	88.60%
Loans & Participations Purchased	3,178,043	2,059,614	1,177,662	684,476
Loans & Participations Sold	8,302,236	8,253,421	5,408,124	2,424,581
Mortg. Loans Serviced for Others	17,656,534	16,615,593	16,620,962	17,120,915
Mortg. Loans Serviced by Others	9,751,888	5,411,300	3,827,412	4,152,919
Broker Originated Deposits	2,545,783	2,002,789	3,233,774	4,721,129
Cash Div. on Preferred Stock	3,966	2,213	0	0
Cash Div. on Permanent Stock	5,072	28,978	13,505	374
Cash Div. on Other Cap. Inst.	0	0	0	0
Non 1-4 Con./Conv.Ins./Tot.Asst	22.66%	20.16%	17.29%	17.10%
Balloon & Adj. Rate Loans	15,650,636	16,663,728	17,903,201	22,268,783
Ser.Corp.Inc./Inv.in Ser.Corp.	16.55%	5.65%	(6.10%)	(7.11%)
OTHER INFORMATION				
Annual Closing Date	N/A	N/A	N/A	N/A
No. of Wholly-Owned Ser. Corps.	138	150	0	N/A
No. of Deposit Accounts	3,978,686	4,070,302	4,131,031	4,529,818

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THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0
BALANCE SHEETS
(Dollars in Thousands)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	$ N/A	$ N/A	$ 773,172	$ 743,929
5 or More Dwelling Units	N/A	N/A	666,635	362,970
Nonresidential	N/A	N/A	1,208,387	821,553
Permanent Mortgages On:				
1-4 Dwelling Units	23,226,479	18,788,735	17,864,471	17,787,134
5 or More Dwelling Units	4,928,435	5,432,421	4,531,625	5,333,635
Nonresidential (Except Land)	6,963,947	6,923,683	5,612,231	5,842,554
Dev. Bldg. Lots, Land, Etc.	2,268,115	2,409,946	1,583,570	1,911,226
Mortgage Backed Securities	11,275,370	24,491,529	28,384,177	25,234,068
Accrued Interest Receivable	615,138	747,122	747,108	580,907
Other Mortgage Receivables	631,846	630,393	108,619	214,218
Loans in Process	(2,456,988)	(2,041,374)	(1,453,346)	(788,999)
Unearned Disc. & Def. Loan Fees	(347,413)	(130,168)	(397,952)	(96,766)
Specific Reserves & Val. Allow.	(287,770)	(572,293)	(938,464)	(259,239)
Net Mortgage Loans	46,817,166	56,679,994	58,690,232	57,687,188
Commercial Loans	785,489	733,624	656,754	902,460
Consumer Loans	1,129,324	1,129,430	1,281,922	1,544,489
Financing Leases	8,784	10,297	17,083	23,247
Accrued Interest Receivable	32,977	38,714	56,437	20,077
Loans in Process	(51,836)	(24,322)	(17,171)	(20,157)
Unearned Disc. & Def. Loan Fees	(16,844)	(15,272)	(18,085)	(17,546)
Specific Reserves & Val. Allow.	(9,634)	(40,349)	(75,158)	(58,418)
Net Nonmortgage Loans	1,878,260	1,832,111	1,901,767	2,394,153
Repossessed Assets	1,532,521	1,601,101	3,155,435	5,234,158
Valuation Allowances	(350,031)	(439,493)	(816,245)	(148,893)
Net Repossessed Assets	1,182,490	1,161,608	2,339,190	5,085,265
Real Estate Held For Dev., Etc.	1,242,385	1,405,931	1,530,943	1,614,177
Valuation Allowances	(72,761)	(84,328)	(122,761)	(11,833)
Net Real Estate Held for Dev.	1,169,624	1,321,603	1,408,182	1,602,344
Cash & Demand Deposits	895,835	1,248,333	836,891	812,560
U.S. Govt. & Agency Securities	2,329,939	1,715,569	3,269,503	2,132,042
Equity Sec., Except FHLB/FHLMC	64,846	32,255	20,369	72,597
Other Investments	3,666,869	4,601,852	5,272,315	9,305,967
Accrued Interest Receivable	50,997	71,924	80,475	94,210
Valuation Allowances	(2,140)	(15,554)	(13,557)	(19,458)
Net Cash & Investment Sec.	7,006,346	7,654,379	9,465,996	12,397,918
Net Fixed Assets	684,712	744,365	776,082	829,760
Investment in Ser. Corps./Subs.	616,241	691,943	1,098,476	1,121,384
Deferred Net Losses (Gains)	328,727	321,018	312,275	295,559
Intangible Assets	1,218,311	1,184,056	1,134,229	67,423
Other Assets	1,589,348	1,667,565	1,552,888	1,995,276
TOTAL ASSETS	$ 62,491,228	$ 73,258,664	$ 78,679,315	$ 83,476,270

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THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0
BALANCE SHEETS
(Dollars in Thousands)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	$ 36,213,223	$ 34,673,848	$ 36,302,761	$ 41,218,046
Transaction Accounts	1,436,853	2,010,977	2,238,047	2,541,303
Money Market Deposit Accounts	5,326,583	5,698,516	5,197,616	5,201,330
Passbook Accounts	2,091,615	2,760,653	3,052,443	3,218,818
Total Savings Deposits	45,068,274	45,143,994	46,790,867	52,179,497
FHLB Advances	5,534,520	6,276,487	6,216,346	7,537,829
Repurchase Agreements	7,330,036	15,396,316	19,032,189	16,985,077
Commercial Paper Issued	100,304	0	0	0
Sub.Deb. not Qual. as Reg.Cap.	10,181	0	0	0
Mortgage-Backed Bonds Issued	639,527	889,506	2,029,460	2,211,450
Other Borrowings	816,816	1,727,927	2,260,493	1,566,891
Other Liabilities	1,383,344	1,783,556	1,462,831	1,550,330
TOTAL LIABILITIES	60,883,014	71,217,800	77,792,193	82,031,076
REGULATORY CAPITAL				
Preferred Stock	33,259	32,922	32,918	400
Permanent Stock	22,188	25,322	24,767	218,623
Contributed Capital	770,456	798,293	810,739	207,862
Qualifying Mutual Cap. Cert.	0	0	0	0
Qualifying Subordinated Deb.	125,843	400,316	521,888	456,184
Appraised Equity Capital	118,903	126,926	122,575	118,180
Net Worth & Income Cap. Cert.	37,325	13,800	7,725	7,725
Retained Earnings (Deficit)	500,241	643,285	(633,491)	436,220
TOTAL REGULATORY CAPITAL	1,608,214	2,040,863	887,121	1,445,194
TOTAL LIAB. & REG. CAPITAL	$ 62,491,228	$ 73,258,663	$ 78,679,314	$ 83,476,270

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THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 6,060,024	$ 5,880,705	$ 6,116,804	$ 4,138,549
Interest Expense	5,463,891	5,117,515	5,399,606	3,869,580
Net Interest Inc. (Exp.)	596,133	763,190	717,198	268,969
Other Operating Income:				
Mortgage Loan Fees	219,305	193,743	147,905	33,089
Loan Servicing Fees	10,730	15,779	17,983	31,191
Other Loan Fees & Charges	49,057	70,388	53,286	23,988
Ser.Chgs. & Fees - Trans.Accts.	22,710	27,510	31,618	26,780
Service Corps./Subsidiaries	93,229	36,956	(54,580)	(59,186)
Other	111,715	30,830	5,987	167,140
Total Oth. Operating Income	506,746	375,206	202,199	223,002
Operating Expense:				
Officers & Employees Comp.	347,148	399,736	447,107	316,425
Legal Expense	16,829	34,581	28,651	28,368
Office Occ. & Equip. Expense	154,163	180,774	194,811	143,204
Marketing Expense	32,893	32,539	40,626	27,671
Professional Services	97,412	73,314	77,033	51,954
Amortization of Goodwill	67,148	69,132	73,756	37,467
Other	286,257	287,983	276,761	184,071
Total Operating Expense	1,001,850	1,078,059	1,138,745	789,160
NET OPER. INCOME (DEFICIT)	101,029	60,337	(219,348)	(297,189)
Non-Operating Income:				
Profit on Sale of REO & Other	36,595	42,160	29,098	20,112
Profit on Sale of Investments	104,087	176,619	107,001	39,932
Profit on Sale of Loans	440,081	754,656	261,315	78,880
Amortized Deferred Gains	535	1,747	1,526	566
Other	31,649	42,904	48,332	26,407
Total Non-Operating Income	612,947	1,018,086	447,272	165,897
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	1,235,670	1,467,121
Loss on Sale of REO & Other	197,492	237,903	66,590	16,162
Loss on Sale of Investments	25,721	81,135	63,808	8,078
Loss on Sale of Loans	92,188	435,556	56,802	14,430
Amortized Deferred Losses	17,599	19,704	20,460	15,710
Other	43,142	47,378	119,107	113,490
Total Non-Operating Expense	376,142	821,676	1,562,437	1,634,991
INCOME (LOSS) BEF. TAXES & ADJ.	337,834	256,747	(1,334,513)	(1,766,283)
Income Taxes (Credits)	90,346	85,543	(72,376)	(14,837)
NET INCOME (LOSS) BEFORE ADJ.	247,467	171,205	(1,254,971)	(1,746,722)
Prior Period Adjustments	(17,327)	(3,597)	(5,593)	(9,924)
ADJUSTED NET INCOME (LOSS)	$ 230,142	$ 167,608	$ (1,260,563)	$ (1,756,648)

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THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	N/A	N/A	0.98	0.89
5 or More Dwelling Units	N/A	N/A	0.85	0.43
Nonresidential	N/A	N/A	1.54	0.98
Permanent Mortgages On:				
1-4 Dwelling Units	37.17	25.65	22.71	21.31
5 or More Dwelling Units	7.89	7.42	5.76	6.39
Nonresidential (Except Land)	11.14	9.45	7.13	7.00
Dev. Bldg. Lots, Land, Etc.	3.63	3.29	2.01	2.29
Mortgage Backed Securities	18.04	33.43	36.08	30.23
Accrued Interest Receivable	0.98	1.02	0.95	0.70
Other Mortgage Receivables	1.01	0.86	0.14	0.26
Loans in Process	(3.93)	(2.79)	(1.85)	(0.95)
Unearned Disc. & Def. Loan Fees	(0.56)	(0.18)	(0.51)	(0.12)
Specific Reserves & Val. Allow.	(0.46)	(0.78)	(1.19)	(0.31)
Net Mortgage Loans	74.92	77.37	74.59	69.11
Commercial Loans	1.26	1.00	0.83	1.08
Consumer Loans	1.81	1.54	1.63	1.85
Financing Leases	0.01	0.01	0.02	0.03
Accrued Interest Receivable	0.05	0.05	0.07	0.02
Loans in Process	(0.08)	(0.03)	(0.02)	(0.02)
Unearned Disc. & Def. Loan Fees	(0.03)	(0.02)	(0.02)	(0.02)
Specific Reserves & Val. Allow.	(0.02)	(0.06)	(0.10)	(0.07)
Net Nonmortgage Loans	3.01	2.50	2.42	2.87
Repossessed Assets	2.45	2.19	4.01	6.27
Valuation Allowances	(0.56)	(0.60)	(1.04)	(0.18)
Net Repossessed Assets	1.89	1.59	2.97	6.09
Real Estate Held For Dev., Etc.	1.99	1.92	1.95	1.93
Valuation Allowances	(0.12)	(0.12)	(0.16)	(0.01)
Net Real Estate Held for Dev.	1.87	1.80	1.79	1.92
Cash & Demand Deposits	1.43	1.70	1.06	0.97
U.S. Govt. & Agency Securities	3.73	2.34	4.16	2.55
Equity Sec., Except FHLB/FHLMC	0.10	0.04	0.03	0.09
Other Investments	5.87	6.28	6.70	11.15
Accrued Interest Receivable	0.08	0.10	0.10	0.11
Valuation Allowances	0.00	(0.02)	(0.02)	(0.02)
Net Cash & Investment Sec.	11.21	10.45	12.03	14.85
Net Fixed Assets	1.10	1.02	0.99	0.99
Investment in Ser. Corps./Subs.	0.99	0.94	1.40	1.34
Deferred Net Losses (Gains)	0.53	0.44	0.40	0.35
Intangible Assets	1.95	1.62	1.44	0.08
Other	2.54	2.28	1.97	2.39
TOTAL ASSETS	100.00	100.00	100.00	100.00

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THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	57.95	47.33	46.14	49.38
Transaction Accounts	2.30	2.75	2.84	3.04
Money Market Deposit Accounts	8.52	7.78	6.61	6.23
Passbook Accounts	3.35	3.77	3.88	3.86
Total Savings Deposits	72.12	61.62	59.47	62.51
FHLB Advances	8.86	8.57	7.30	9.03
Repurchase Agreements	11.73	21.02	24.19	20.35
Commercial Paper Issued	0.16	0.00	0.00	0.00
Sub. Deb. not Qual. as Reg. Cap.	0.02	0.00	0.00	0.00
Mortgage-Backed Bonds Issued	1.02	1.21	2.58	2.65
Other Borrowings	1.31	2.36	2.87	1.88
Other Liabilities	2.21	2.43	1.86	1.86
TOTAL LIABILITIES	97.43	97.21	98.87	98.27
REGULATORY CAPITAL				
Preferred Stock	0.05	0.04	0.04	0.00
Permanent Stock	0.04	0.03	0.03	0.26
Contributed Capital	1.23	1.09	1.03	0.25
Qualifying Mutual Cap. Cert.	0.00	0.00	0.00	0.00
Qualifying Subordinated Deb.	0.20	0.55	0.66	0.55
Appraised Equity Capital	0.19	0.17	0.16	0.14
Net Worth & Income Cap. Cert.	0.06	0.02	0.01	0.01
Retained Earnings (Deficit)	0.80	0.88	(0.81)	0.52
TOTAL REGULATORY CAPITAL	2.57	2.79	1.13	1.73
TOTAL LIABILITIES & REG. CAP.	100.00	100.00	100.00	100.00

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THRIFTS W/POS. GAAP CAP<1.5%,TAN>$0
FINANCIAL RATIOS - STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	1985	1986	1987	9/30/88
Interest Income	9.91	8.66	8.05	6.81
Interest Expense	8.93	7.54	7.11	6.36
Net Interest Inc. (Exp.)	0.97	1.12	0.94	0.44
Other Operating Income:				
Mortgage Loan Fees	0.36	0.29	0.19	0.05
Loan Servicing Fees	0.02	0.02	0.02	0.05
Other Loan Fees & Charges	0.08	0.10	0.07	0.04
Ser.Chgs. & Fees-Trans.Accts	0.04	0.04	0.04	0.04
Service Corps./Subsidiaries	0.15	0.05	(0.07)	(0.10)
Other	0.18	0.05	0.01	0.27
Total Oth. Operating Income	0.83	0.55	0.27	0.37
Operating Expense:				
Officers & Employees Comp.	0.57	0.59	0.59	0.52
Legal Expense	0.03	0.05	0.04	0.05
Office Occ. & Equip. Expense	0.25	0.27	0.26	0.24
Marketing Expense	0.05	0.05	0.05	0.05
Professional Services	0.16	0.11	0.10	0.09
Amortization of Goodwill	0.11	0.10	0.10	0.06
Other	0.47	0.42	0.36	0.30
Total Operating Expense	1.64	1.59	1.50	1.30
NET OPER. INCOME (DEFICIT)	0.17	0.09	(0.29)	(0.49)
Non-Operating Income:				
Profit on Sale of REO & Other	0.06	0.06	0.04	0.03
Profit on Sale of Investments	0.17	0.26	0.14	0.07
Profit on Sale of Loans	0.72	1.11	0.34	0.13
Amortized Deferred Gains	0.00	0.00	0.00	0.00
Other	0.05	0.06	0.06	0.04
Total Non-Operating Income	1.00	1.50	0.59	0.27
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	1.63	2.41
Loss on Sale of REO & Other	0.32	0.35	0.09	0.03
Loss on Sale of Investments	0.04	0.12	0.08	0.01
Loss on Sale of Loans	0.15	0.64	0.07	0.02
Amortized Deferred Losses	0.03	0.03	0.03	0.03
Other	0.07	0.07	0.16	0.19
Total Non-Operating Expense	0.61	1.21	2.06	2.69
INCOME (LOSS) BEF. TAXES & ADJ.	0.55	0.38	(1.76)	(2.90)
Income Taxes (Credits)	0.15	0.13	(0.10)	(0.02)
NET INCOME (LOSS) BEFORE ADJ.	0.40	0.25	(1.65)	(2.87)
Prior Period Adjustments	(0.03)	(0.01)	(0.01)	(0.02)
ADJUSTED NET INCOME (LOSS)	0.38	0.25	(1.66)	(2.89)

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II

THRIFTS W/POS. GAAP CAP<1.5%,TNW>$0
QUARTERLY STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	$ 1,585,922	$ 1,556,707	$ 1,482,414	$ 1,099,428
Interest Expense	1,464,650	1,444,643	1,385,640	1,039,297
Net Interest Inc. (Exp.)	121,272	112,064	96,774	60,131
Other Operating Income:				
Mortgage Loan Fees	33,843	8,969	12,767	11,353
Loan Servicing Fees	4,449	12,556	8,770	9,865
Other Loan Fees & Charges	11,800	8,706	8,058	7,224
Ser.Chgs. & Fees-Trans.Accts	8,414	8,452	9,145	9,183
Service Corps./Subsidiaries	14,364	(37,859)	(10,130)	(11,197)
Other	7,458	21,502	40,412	105,226
Total Oth. Operating Income	80,328	22,326	69,022	131,654
Operating Expense:				
Officers & Employees Comp.	114,572	116,482	112,355	87,588
Legal Expense	11,000	12,485	10,795	5,088
Office Occ. & Equip. Expense	49,550	49,930	51,231	42,043
Marketing Expense	12,146	9,060	8,426	10,185
Professional Services	20,867	20,679	21,840	9,435
Amortization of Goodwill	18,689	17,410	18,430	1,627
Other	68,149	64,924	63,265	55,882
Total Operating Expense	294,973	290,970	286,342	211,848
NET OPER. INCOME (DEFICIT)	(93,373)	(156,580)	(120,546)	(20,063)
Non-Operating Income:				
Profit on Sale of REO & Other	6,874	5,925	10,418	3,769
Profit on Sale of Investments	12,306	19,233	5,868	14,831
Profit on Sale of Loans	24,126	72,999	3,468	2,413
Amortized Deferred Gains	235	235	238	93
Other	30,925	12,730	8,650	5,027
Total Non-Operating Income	74,466	111,122	28,642	26,133
Non-Operating Expense:				
Provision for Losses on Assets	622,228	1,220,547	202,747	43,827
Loss on Sale of REO & Other	6,468	4,395	4,749	7,018
Loss on Sale of Investments	5,451	5,775	1,218	1,085
Loss on Sale of Loans	20,214	11,704	1,869	857
Amortized Deferred Losses	5,083	5,138	5,154	5,418
Other	12,186	100,659	8,957	3,874
Total Non-Operating Expense	671,630	1,348,218	224,694	62,079
INCOME (LOSS) BEF. TAXES & ADJ.	(690,537)	(1,393,676)	(316,598)	(56,009)
Income Taxes (Credits)	(34,635)	(10,259)	(6,457)	1,879
NET INCOME (LOSS) BEFORE ADJ.	(652,043)	(1,378,702)	(310,136)	(57,884)
Prior Period Adjustments	(100)	1,926	(11,692)	(158)
ADJUSTED NET INCOME (LOSS)	$ (652,144)	$ (1,376,778)	$ (321,828)	$ (58,042)

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THRIFTS W/POS. GAAP CAP<1.5%,TNW>$0
FINANCIAL RATIOS - QUARTERLY STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	8.35	7.68	7.31	5.42
Interest Expense	7.71	7.13	6.84	5.13
Net Interest Inc. (Exp.)	0.64	0.55	0.48	0.30
Other Operating Income:				
Mortgage Loan Fees	0.18	0.04	0.06	0.06
Loan Servicing Fees	0.02	0.06	0.04	0.05
Other Loan Fees & Charges	0.06	0.04	0.04	0.04
Ser.Chgs. & Fees-Trans.Accts	0.04	0.04	0.05	0.05
Service Corps./Subsidiaries	0.08	(0.19)	(0.05)	(0.06)
Other	0.04	0.11	0.20	0.52
Total Other Oper. Income	0.42	0.11	0.34	0.65
Operating Expense:				
Officers & Employees Comp.	0.60	0.57	0.55	0.43
Legal Expense	0.06	0.06	0.05	0.03
Office Occ. & Equip. Expense	0.26	0.25	0.25	0.21
Marketing Expense	0.06	0.04	0.04	0.05
Professional Services	0.11	0.10	0.11	0.05
Amortization of Goodwill	0.10	0.09	0.09	0.01
Other	0.36	0.32	0.31	0.28
Total Operating Expense	1.55	1.44	1.41	1.05
NET OPER. INCOME (DEFICIT)	(0.49)	(0.77)	(0.59)	(0.10)
Non-Operating Income:				
Profit on Sale of REO & Other	0.04	0.03	0.05	0.02
Profit on Sale of Investments	0.06	0.09	0.03	0.07
Profit on Sale of Loans	0.13	0.36	0.02	0.01
Amortized Deferred Gains	0.00	0.00	0.00	0.00
Other	0.16	0.06	0.04	0.02
Total Non-Operating Income	0.39	0.55	0.14	0.13
Non-Operating Expense:				
Provision for Losses on Assets	3.28	6.02	1.00	0.22
Loss on Sale of REO & Other	0.03	0.02	0.02	0.03
Loss on Sale of Investments	0.03	0.03	0.01	0.01
Loss on Sale of Loans	0.11	0.06	0.01	0.00
Amortized Deferred Losses	0.03	0.03	0.03	0.03
Other	0.06	0.50	0.04	0.02
Total Non-Operating Expense	3.54	6.65	1.11	0.31
INCOME (LOSS) BEF. TAXES & ADJ.	(3.64)	(6.88)	(1.56)	(0.28)
Income Taxes (Credits)	(0.18)	(0.05)	(0.03)	0.01
NET INCOME (LOSS) BEFORE ADJ.	(3.43)	(6.80)	(1.53)	(0.29)
Prior Period Adjustments	(0.00)	0.01	(0.06)	(0.00)
ADJUSTED NET INCOME (LOSS)	(3.43)	(6.79)	(1.59)	(0.29)

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EXHIBIT IX

SUMMARY OF THRIFTS WITH TANGIBLE CAPITAL LESS THAN OR EQUAL TO $0
NET OF CASE RESOLUTIONS DURING THE THREE MONTHS ENDED DECEMBER 31, 1988
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Conv/Conv Lns/Assts	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
CT Totals, 1 Institution	142,913	4	(16,643)	(11.65)	(20,072)	(14.05)	(20,072)	(14.05)	87.28	5.36	0	(0.06)	(3,835)	(3.46)	(9,937)	(8.96)	3.46
ME Totals, 1 Institution	81,967	5	3,001	3.30	2,061	3.39	(5,406)	(0.86)	86.21	13.83	0.03	0.02	(243)	(0.53)	(421)	(0.91)	2.97
MA Totals, 1 Institution	280,400	8	18,652	6.65	15,652	6.60	(5,902)	(1.99)	92.33	60.23	0.06	0.46	(820)	(0.38)	(760)	(0.35)	3.26
NH Totals, 1 Institution	153,325	1	5,588	3.64	5,588	3.64	(1,162)	(0.76)	90.54	9.63	0.06	3.31	(1,062)	(0.90)	(979)	(0.86)	3.06
NJ Totals, 18 Institutions	13,095,085	237	500,587	3.86	273,844	2.10	(308,190)	(2.36)	95.66	13.30	0.35	1.70	6,378	0.07	(34,231)	(0.36)	2.62
NY Totals, 12 Institutions	34,961,132	397	1,431,575	4.10	1,122,906	3.21	(1,809,717)	(3.69)	90.83	10.11	0.37	2.40	32,188	0.13	(44,079)	(0.17)	2.01
DE Totals, 1 Institution	317,576	10	10,822	3.41	10,822	3.41	(7,388)	(2.32)	93.18	6.07	0	0.02	(1,082)	(0.50)	(300)	(0.14)	2.67
PA Totals, 11 Institutions	16,485,084	261	557,814	3.38	337,830	2.05	(564,558)	(3.42)	91.05	15.16	0.52	1.01	(8,659)	(0.07)	(77,416)	(0.63)	1.85
WV Totals, 1 Institution	82,151	2	2,143	2.61	2,143	2.61	(4,973)	(6.05)	88.62	11.77	2.03	0.07	30	0.05	(1,021)	(1.65)	2.22
AL Totals, 6 Institutions	4,267,528	104	15,888	0.37	(20,356)	(0.48)	(138,578)	(3.25)	90.05	13.34	1.96	1.73	(15,633)	(0.49)	(56,950)	(1.70)	1.75
FL Totals, 24 Institutions	10,963,636	206	(430,818)	(3.93)	(500,102)	(4.56)	(962,268)	(8.78)	86.29	17.09	2.48	1.43	(115,307)	(1.39)	(215,168)	(2.60)	2.55
GA Totals, 11 Institutions	4,627,106	104	88,813	1.88	44,132	0.95	(75,389)	(1.63)	93.57	10.34	1.58	1.66	(7,479)	(0.22)	(10,618)	(0.31)	1.89
MD Totals, 9 Institutions	5,371,963	119	1,799	0.03	(114,148)	(2.12)	(393,382)	(7.32)	87.87	24.37	0.75	1.86	(21,278)	(0.54)	(22,017)	(0.55)	2.67
NC Totals, 8 Institutions	2,326,198	75	63,991	2.75	(17,502)	(0.75)	(111,373)	(4.79)	89.32	10.94	0.81	1.49	927	0.05	(6,216)	(0.36)	2.38
SC Totals, 4 Institutions	2,291,134	70	38,908	1.70	(5,611)	(0.24)	(74,599)	(3.25)	90.56	13.47	0.35	0.74	7,565	0.44	2,683	0.16	2.19
VA Totals, 11 Institutions	5,396,998	97	274,915	4.91	74,474	1.38	(206,738)	(3.69)	96.69	12.06	1.40	0.55	(13,081)	(0.35)	(11,134)	(0.30)	2.28
KY Totals, 1 Institution	548,082	16	10,934	1.99	6,203	1.18	(15,811)	(2.88)	92.57	9.68	0.28	0.08	809	0.20	512	0.13	1.81
OH Totals, 23 Institutions	12,679,799	291	531,297	4.19	262,783	2.07	(250,837)	(2.06)	92.49	15.51	0.84	1.54	20,001	0.21	18,609	0.20	2.14
TN Totals, 6 Institutions	462,351	19	(5,654)	(1.22)	(28,036)	(6.06)	(40,152)	(8.68)	85.56	10.85	1.69	1.59	(2,330)	(0.66)	(4,352)	(1.23)	2.62
IN Totals, 8 Institutions	2,313,507	80	118,690	5.13	107,182	4.68	(35,063)	(1.51)	91.14	3.38	0.81	0.16	13,165	0.83	3,791	0.24	2.05
MI Totals, 5 Institutions	656,717	22	(22,611)	(3.44)	(33,633)	(5.12)	(46,501)	(7.08)	86.76	15.70	2.84	1.74	(5,720)	(1.17)	(5,871)	(1.20)	4.23
IL Totals, 58 Institutions	22,880,065	338	751,635	3.29	321,479	1.41	(1,009,287)	(4.46)	90.09	5.99	0.67	1.00	22,829	0.14	(20,768)	(0.12)	2.07
WI Totals, 3 Institutions	398,256	23	(31,154)	(7.82)	(31,154)	(7.82)	(44,663)	(11.21)	82.18	13.36	2.56	2.03	(4,112)	(1.40)	(10,145)	(3.45)	3.08
IA Totals, 2 Institutions	1,166,065	32	(8,475)	(0.73)	(18,610)	(1.60)	(57,088)	(4.99)	93.39	15.74	2.09	0.25	(2,591)	(0.30)	(25,788)	(2.00)	1.69

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SUMMARY OF THRIFTS WITH TANGIBLE CAPITAL LESS THAN OR EQUAL TO 00
NET OF CASE RESOLUTIONS DURING THE THREE MONTHS ENDED DECEMBER 31, 1988
SELECTED FINANCIAL INFORMATION AT SEPTEMBER 30, 1988

Institution Name	Total Assets	# of Brnchs	Regulatory Capital	Reg. Cap./ Assets	Estimated GAAP Cap.	Est. GAAP Capital/ Assets	Tangible Capital	Tangible Capital/ Assets	Int.Earn. Asst/Int. Bear.Liab	Non 1-4 Con/Conv Lns/Assets	Net Repos Assets/ Tot Asst	Serv.Corp Inv./ Tot Asst	Net Oper. Income (Loss)	Net Op. Inc(Loss)/ Avg Asst	Adjusted Net Income (Loss)	Adj. Net Inc(Loss)/ Avg Asst	Total Op. Exp/ Avg Asst
MN Totals, 5 Institutions	7,152,418	104	243,108	3.40	(25,137)	(0.35)	(300,062)	(4.31)	87.12	15.61	0.72	4.25	(22,333)	(0.42)	(19,215)	(0.36)	1.64
MO Totals, 12 Institutions	7,960,800	137	7,154	0.09	(156,215)	(1.96)	(464,819)	(5.84)	91.57	9.08	2.11	0.20	(50,660)	(0.97)	(161,156)	(2.68)	1.96
ND Totals, 3 Institutions	1,376,446	36	45,209	3.28	7,859	0.57	(80,756)	(5.87)	90.97	14.79	0.75	0.02	1,251	0.13	(1,008)	(0.16)	1.65
SD Totals, 3 Institutions	159,150	7	(1,091)	(0.69)	(4,769)	(3.00)	(6,575)	(4.13)	91.60	20.34	2.05	0.17	1,026	0.84	818	0.67	1.87
AR Totals, 15 Institutions	4,758,832	164	(664,904)	(13.97)	(745,994)	(15.68)	(908,793)	(19.10)	77.63	31.30	7.75	2.03	(104,325)	(2.05)	(324,857)	(0.86)	2.06
LA Totals, 33 Institutions	6,341,331	182	(467,975)	(7.38)	(564,479)	(8.90)	(964,598)	(15.21)	76.66	17.42	5.19	0.86	(115,757)	(2.38)	(228,873)	(4.70)	2.34
MS Totals, 13 Institutions	1,724,157	59	(43,085)	(2.50)	(96,167)	(5.58)	(167,872)	(9.74)	80.87	14.82	3.00	2.98	(15,448)	(1.20)	(67,396)	(5.21)	2.47
NM Totals, 9 Institutions	1,965,268	73	(581,078)	(29.57)	(603,550)	(30.71)	(709,341)	(36.09)	68.95	32.73	7.12	0.85	(92,054)	(5.63)	(434,163)	(26.54)	2.87
TX Totals, 88 Institutions	31,093,083	546	(3,814,572)	(11.96)	(4,169,319)	(13.07)	(5,757,860)	(18.05)	63.47	22.34	14.31	4.52	(875,501)	(3.83)	(2,223,445)	(9.72)	2.17
CO Totals, 12 Institutions	1,690,649	47	(164,768)	(9.75)	(173,466)	(10.26)	(193,670)	(11.46)	77.20	32.96	8.06	2.05	(60,723)	(4.86)	(86,413)	(6.91)	2.00
KS Totals, 16 Institutions	3,677,605	88	(134,021)	(3.64)	(172,223)	(4.68)	(222,855)	(6.06)	85.67	17.03	6.21	0.73	(36,539)	(1.33)	(74,424)	(2.71)	1.76
NE Totals, 11 Institutions	3,600,128	112	(114,311)	(3.18)	(171,465)	(4.76)	(214,944)	(5.97)	86.13	14.66	4.42	0.92	(41,306)	(1.53)	(96,622)	(3.59)	2.25
OK Totals, 12 Institutions	4,543,238	80	120,581	2.65	111,183	2.45	(142,138)	(3.13)	83.44	12.01	6.76	3.01	(10,664)	(0.42)	(23,626)	(0.92)	2.11
AZ Totals, 3 Institutions	3,218,787	76	(335,212)	(10.41)	(335,212)	(10.41)	(448,336)	(13.93)	72.77	32.95	6.26	4.33	(58,828)	(2.50)	(148,058)	(6.29)	1.72
CA Totals, 25 Institutions	9,026,934	146	(337,444)	(3.74)	(383,039)	(4.24)	(777,464)	(8.61)	85.44	19.64	1.64	1.27	(134,181)	(2.16)	(125,935)	(2.00)	2.67
AK Totals, 2 Institutions	309,720	11	(89,386)	(28.86)	(89,386)	(28.86)	(89,830)	(29.00)	66.73	50.46	4.76	1.79	(16,901)	(5.63)	(63,582)	(24.01)	3.96
HI Totals, 1 Institution	2,557,236	32	97,963	3.83	57,963	2.27	(35,583)	(1.39)	96.76	9.99	0.69	0.52	7,101	0.40	15,716	0.89	2.03
OR Totals, 4 Institutions	8,720,418	152	222,352	2.55	207,927	2.38	(389,865)	(4.47)	89.61	10.67	0.76	1.34	(8,683)	(0.14)	(10,419)	(0.17)	1.86
UT Totals, 3 Institutions	2,657,016	123	(112,899)	(4.25)	(114,547)	(4.31)	(280,872)	(10.57)	82.30	18.33	2.55	0.72	(20,308)	(1.08)	(1,164)	(0.06)	2.51
WA Totals, 2 Institutions	1,918,061	19	101,246	5.28	83,783	4.37	(51,240)	(2.67)	93.65	12.94	1.16	0.45	587	0.04	169	0.01	1.77
WY Totals, 3 Institutions	794,441	31	(96,482)	(12.14)	(108,625)	(13.67)	(108,685)	(13.68)	76.98	11.53	5.33	2.23	(26,197)	(4.24)	(37,520)	(6.08)	3.86
Grand Totals, 501 Institutions	248,094,834	4,811	(2,209,708)	(0.89)	(5,644,005)	(2.27)	(18,011,657)	(7.26)	84.97	15.14	3.35	2.00	(1,785,863)	(0.99)	(4,644,245)	(2.57)	2.15

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Docket
Charter
District
Branches 4,811

THRIFTS W/TANG. CAP. <= 0, NET

EXHIBIT X

FINANCIAL HIGHLIGHTS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Total Assets	$ 193,749,814	$ 214,693,675	$ 234,273,291	$ 248,094,034
% Change in Assets	10.27%	10.81%	9.12%	5.90%
Regulatory Capital	6,351,665	6,148,796	2,946,600	(2,209,708)
Estimated GAAP Capital	2,258,920	2,007,116	(580,143)	(5,644,005)
Tangible Capital	(7,641,402)	(7,671,388)	(12,681,290)	(18,011,657)
Regulatory Capital/Total Assets	3.28%	2.86%	1.26%	(0.89%)
Est. GAAP Capital/Total Assets	1.17%	0.93%	(0.25%)	(2.27%)
Tangible Capital/Total Assets	(3.94%)	(3.57%)	(5.41%)	(7.26%)
Net Income (Loss)	180,219	(1,005,909)	(3,533,073)	(4,644,245)
Return on Average Assets	0.10%	(0.49%)	(1.57%)	(2.57%)
Return on Avg. Regulatory Cap.	3.06%	(16.09%)	(77.69%)	(680.66%)
Yield on Loans	11.75%	10.93%	9.62%	9.57%
Yield on Investments	9.32%	7.90%	7.30%	7.94%
Yield on Earning Assets	11.44%	10.55%	9.33%	9.37%
Cost of Savings	9.01%	7.93%	6.82%	7.20%
Cost of Borrowings	9.89%	9.08%	7.85%	7.84%
Cost of Funds	9.14%	8.12%	7.01%	7.33%
Yield/Cost Spread	2.30%	2.43%	2.32%	2.04%
Amt.Elig. for Reg. Liquidity	17,913,219	19,782,297	16,761,888	16,669,032
Amt.Elig. for Reg.Liq./Tot.Assets	9.25%	9.21%	7.15%	6.72%
Int.Earn.Asst./Int.Bear.Liab.	89.08%	88.25%	86.73%	84.97%
Loans & Participations Purchased	15,023,201	17,677,550	16,409,982	9,364,915
Loans & Participations Sold	19,707,402	29,031,011	23,789,560	13,092,639
Mortg. Loans Serviced for Others	50,461,495	53,128,701	74,057,146	85,893,869
Mortg. Loans Serviced by Others	32,516,005	33,307,917	33,310,285	36,581,636
Broker Originated Deposits	3,111,837	3,974,753	6,475,177	8,271,406
Cash Div. on Preferred Stock	6,241	11,147	25,404	19,486
Cash Div. on Permanent Stock	32,780	52,206	33,029	20,567
Cash Div. on Other Cap. Inst.	731	13,551	9,259	499
Non 1-4 Con./Conv.Lns./Tot.Asst	20.20%	18.76%	17.09%	15.14%
Balloon & Adj. Rate Loans	50,528,663	56,673,428	66,876,610	75,750,693
Ser.Corp.Inc./Inv.in Ser.Corp.	7.94%	3.83%	(4.49%)	(3.86%)
OTHER INFORMATION				
Annual Closing Date	N/A	N/A	N/A	N/A
No. of Wholly-Owned Ser. Corps.	890	1,007	0	N/A
No. of Deposit Accounts	22,647,723	23,047,763	23,465,648	23,867,499

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THRIFTS W/TANG. CAP. <= 0, NET
BALANCE SHEETS
(Dollars in Thousands)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	$ N/A	$ N/A	$ 3,381,638	$ 3,628,910
5 or More Dwelling Units	N/A	N/A	2,388,245	1,914,373
Nonresidential	N/A	N/A	4,273,443	3,585,988
Permanent Mortgages On:				
1-4 Dwelling Units	73,546,842	74,949,483	80,033,767	84,584,334
5 or More Dwelling Units	12,642,995	12,663,341	10,621,937	10,489,652
Nonresidential (Except Land)	19,293,383	20,627,625	16,577,369	16,573,736
Dev. Bldg. Lots, Land, Etc.	7,200,971	6,991,847	6,172,644	5,006,800
Mortgage Backed Securities	21,108,533	27,586,222	35,532,098	38,713,481
Accrued Interest Receivable	1,788,105	1,976,567	2,275,984	2,147,247
Other Mortgage Receivables	5,638,408	6,564,721	1,039,579	1,227,506
Loans in Process	(5,230,835)	(4,368,294)	(3,649,388)	(3,118,406)
Unearned Disc. & Def. Loan Fees	(4,382,721)	(3,277,762)	(2,942,928)	(2,416,427)
Specific Reserves & Val. Allow.	(1,136,241)	(1,685,343)	(3,123,918)	(3,586,273)
Net Mortgage Loans	130,469,449	142,028,405	152,580,473	158,750,922
Commercial Loans	3,789,650	4,535,627	4,955,074	5,278,980
Consumer Loans	10,021,382	11,418,046	13,838,938	15,862,833
Financing Leases	328,335	463,868	530,717	496,605
Accrued Interest Receivable	186,676	213,228	246,233	253,507
Loans in Process	(86,235)	(58,459)	(56,997)	(48,066)
Unearned Disc. & Def. Loan Fees	(167,994)	(156,753)	(106,726)	(54,528)
Specific Reserves & Val. Allow.	(128,921)	(266,448)	(472,780)	(639,492)
Net Nonmortgage Loans	13,942,924	16,149,109	18,934,472	21,149,844
Repossessed Assets	2,179,117	4,648,556	7,681,216	10,152,986
Valuation Allowances	(296,224)	(788,407)	(1,665,785)	(1,853,717)
Net Repossessed Assets	1,882,893	3,860,149	6,015,431	8,299,269
Real Estate Held For Dev., Etc.	1,174,436	1,354,293	1,582,934	1,820,406
Valuation Allowances	(48,651)	(96,713)	(237,849)	(261,793)
Net Real Estate Held for Dev.	1,125,785	1,257,580	1,345,085	1,558,613
Cash & Demand Deposits	2,549,989	3,294,156	3,071,674	2,945,161
U.S. Govt. & Agency Securities	6,411,083	6,526,842	8,429,163	6,775,392
Equity Sec., Except FHLB/FHLMC	228,092	227,037	124,476	404,609
Other Investments	13,587,196	16,073,974	16,254,981	20,115,301
Accrued Interest Receivable	242,838	221,638	283,825	324,286
Valuation Allowances	(12,235)	(10,602)	(22,362)	(36,378)
Net Cash & Investment Sec.	23,006,963	26,333,045	28,141,757	30,528,371
Net Fixed Assets	2,586,960	2,758,237	2,947,868	3,021,108
Investment in Ser. Corps./Subs.	3,723,545	4,651,152	4,576,030	4,958,990
Deferred Net Losses (Gains)	2,502,318	2,482,049	2,146,876	2,005,630
Intangible Assets	9,900,322	9,678,504	12,101,147	12,367,652
Other Assets	4,608,667	5,495,440	5,484,165	5,453,637
TOTAL ASSETS	$ 193,749,814	$ 214,693,675	$ 234,273,291	$ 248,094,034

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THRIFTS W/TANG. CAP. <= 0, NET
BALANCE SHEETS
(Dollars in Thousands)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	$ 111,157,941	$ 116,064,150	$ 129,186,884	$ 139,864,520
Transaction Accounts	7,353,887	10,860,359	11,566,668	12,731,864
Money Market Deposit Accounts	25,458,070	27,427,351	23,088,542	22,032,883
Passbook Accounts	12,463,479	15,885,775	17,770,844	18,364,101
Total Savings Deposits	156,433,377	170,237,635	181,612,938	192,993,368
FHLB Advances	17,636,160	22,028,589	26,812,715	29,117,440
Repurchase Agreements	5,689,876	6,365,729	11,109,242	13,615,087
Commercial Paper Issued	16,900	19,916	9,980	41,032
Sub.Deb. not Qual. as Reg.Cap.	20,671	29,920	42,757	42,800
Mortgage-Backed Bonds Issued	722,570	1,182,833	1,731,121	1,923,307
Other Borrowings	3,466,966	4,943,925	6,234,544	8,180,934
Other Liabilities	3,411,620	3,736,310	3,773,374	4,389,766
TOTAL LIABILITIES	187,398,150	208,544,877	231,326,693	250,303,739
REGULATORY CAPITAL				
Preferred Stock	45,835	80,561	404,641	406,827
Permanent Stock	175,682	237,770	305,357	296,150
Contributed Capital	1,448,761	2,018,771	2,880,645	3,116,735
Qualifying Mutual Cap. Cert.	0	785	2,840	0
Qualifying Subordinated Deb.	229,030	397,084	393,622	501,083
Appraised Equity Capital	480,911	630,767	555,890	496,942
Net Worth & Income Cap. Cert.	951,008	731,948	486,994	477,885
Retained Earnings (Deficit)	3,020,433	2,051,099	(2,083,382)	(7,505,328)
TOTAL REGULATORY CAPITAL	6,351,665	6,148,796	2,946,600	(2,209,708)
TOTAL LIAB. & REG. CAPITAL	$ 193,749,815	$ 214,693,670	$ 234,273,293	$ 248,094,033

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THRIFTS W/TANG. CAP. <= 0, NET
STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	1985	1986	1987	9/30/88
Interest Income	$ 17,906,658	$ 18,356,498	$ 17,586,778	$ 14,191,010
Interest Expense	15,983,535	15,898,213	15,114,634	12,929,779
Net Interest Inc. (Exp.)	1,923,123	2,458,285	2,472,144	1,261,231
Other Operating Income:				
Mortgage Loan Fees	629,115	623,150	511,822	228,513
Loan Servicing Fees	194,272	230,683	219,146	211,334
Other Loan Fees & Charges	149,480	183,824	171,348	118,752
Ser.Chgs. & Fees - Trans.Accts.	133,709	174,806	197,227	170,864
Service Corps./Subsidiaries	256,026	160,283	(207,232)	(138,032)
Other	407,698	389,905	286,255	257,128
Total Oth. Operating Income	1,770,300	1,762,651	1,178,566	848,559
Operating Expense:				
Officers & Employees Comp.	1,408,711	1,663,945	1,777,584	1,408,241
Legal Expense	54,605	89,433	116,373	113,341
Office Occ. & Equip. Expense	746,145	860,076	925,788	753,201
Marketing Expense	163,812	170,104	184,676	128,226
Professional Services	75,736	116,497	118,664	108,746
Amortization of Goodwill	360,599	502,608	519,160	369,845
Other	1,145,002	1,296,833	1,328,301	1,014,053
Total Operating Expense	3,954,610	4,699,496	4,970,546	3,895,653
NET OPER. INCOME (DEFICIT)	(261,187)	(478,560)	(1,319,836)	(1,785,863)
Non-Operating Income:				
Profit on Sale of REO & Other	103,875	105,459	123,653	93,250
Profit on Sale of Investments	357,906	576,157	206,744	212,132
Profit on Sale of Loans	597,483	839,283	605,137	281,575
Amortized Deferred Gains	30,714	11,623	12,854	4,565
Other	407,410	371,589	226,503	169,479
Total Non-Operating Income	1,497,388	1,904,111	1,174,891	761,001
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	2,362,225	2,945,237
Loss on Sale of REO & Other	195,733	527,314	152,357	108,801
Loss on Sale of Investments	65,373	78,263	123,644	128,084
Loss on Sale of Loans	444,891	1,153,403	180,462	128,998
Amortized Deferred Losses	104,372	129,343	166,430	96,612
Other	138,050	314,427	329,445	98,686
Total Non-Operating Expense	948,419	2,202,750	3,314,563	3,506,418
INCOME (LOSS) BEF. TAXES & ADJ.	287,782	(777,199)	(3,459,508)	(4,531,280)
Income Taxes (Credits)	27,805	(57,600)	30,954	14,850
NET INCOME (LOSS) BEFORE ADJ.	259,798	(719,730)	(3,482,170)	(4,541,924)
Prior Period Adjustments	(79,581)	(286,185)	(50,901)	(102,323)
ADJUSTED NET INCOME (LOSS)	$ 180,219	$ (1,005,909)	$ (3,533,073)	$ (4,644,245)

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THRIFTS W/TANG. CAP. <= 0, NET
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

ASSETS	1985	1986	1987	9/30/88
Construction Loans On:				
1-4 Dwelling Units	N/A	N/A	1.44	1.46
5 or More Dwelling Units	N/A	N/A	1.02	0.77
Nonresidential	N/A	N/A	1.82	1.45
Permanent Mortgages On:				
1-4 Dwelling Units	37.96	34.91	34.16	34.09
5 or More Dwelling Units	6.53	5.90	4.53	4.23
Nonresidential (Except Land)	9.96	9.61	7.08	6.68
Dev. Bldg. Lots, Land, Etc.	3.72	3.26	2.63	2.02
Mortgage Backed Securities	10.89	12.85	15.17	15.60
Accrued Interest Receivable	0.92	0.92	0.97	0.87
Other Mortgage Receivables	2.91	3.06	0.44	0.49
Loans in Process	(2.70)	(2.03)	(1.56)	(1.26)
Unearned Disc. & Def. Loan Fees	(2.26)	(1.53)	(1.26)	(0.97)
Specific Reserves & Val. Allow.	(0.59)	(0.78)	(1.33)	(1.45)
Net Mortgage Loans	67.34	66.15	65.13	63.99
Commercial Loans	1.96	2.11	2.12	2.13
Consumer Loans	5.17	5.32	5.91	6.39
Financing Leases	0.17	0.22	0.23	0.20
Accrued Interest Receivable	0.10	0.10	0.11	0.10
Loans in Process	(0.04)	(0.03)	(0.02)	(0.02)
Unearned Disc. & Def. Loan Fees	(0.09)	(0.07)	(0.05)	(0.02)
Specific Reserves & Val. Allow.	(0.07)	(0.12)	(0.20)	(0.26)
Net Nonmortgage Loans	7.20	7.52	8.08	8.52
Repossessed Assets	1.12	2.17	3.28	4.09
Valuation Allowances	(0.15)	(0.37)	(0.71)	(0.75)
Net Repossessed Assets	0.97	1.80	2.57	3.35
Real Estate Held For Dev., Etc.	0.61	0.63	0.68	0.73
Valuation Allowances	(0.03)	(0.05)	(0.10)	(0.11)
Net Real Estate Held for Dev.	0.58	0.59	0.57	0.63
Cash & Demand Deposits	1.32	1.53	1.31	1.19
U.S. Govt. & Agency Securities	3.31	3.04	3.60	2.73
Equity Sec., Except FHLB/FHLMC	0.12	0.11	0.05	0.16
Other Investments	7.01	7.49	6.94	8.11
Accrued Interest Receivable	0.13	0.10	0.12	0.13
Valuation Allowances	(0.01)	0.00	(0.01)	(0.01)
Net Cash & Investment Sec.	11.87	12.27	12.01	12.31
Net Fixed Assets	1.34	1.28	1.26	1.22
Investment in Ser. Corps./Subs.	1.92	2.17	1.95	2.00
Deferred Net Losses (Gains)	1.29	1.16	0.92	0.81
Intangible Assets	5.11	4.51	5.17	4.99
Other	2.38	2.56	2.34	2.20
TOTAL ASSETS	100.00	100.00	100.00	100.00

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THRIFTS W/TANG. CAP. <= 0, NET
FINANCIAL RATIOS - BALANCE SHEETS
(As a Percent of Total Assets)

LIABILITIES	1985	1986	1987	9/30/88
Fixed-Maturity Deposits	57.37	54.06	55.14	56.38
Transaction Accounts	3.80	5.06	4.94	5.13
Money Market Deposit Accounts	13.14	12.78	9.86	8.88
Passbook Accounts	6.43	7.40	7.59	7.40
Total Savings Deposits	80.74	79.29	77.52	77.79
FHLB Advances	9.10	10.26	11.45	11.74
Repurchase Agreements	2.94	2.97	4.74	5.49
Commercial Paper Issued	0.01	0.01	0.00	0.02
Sub. Deb. not Qual. as Reg. Cap.	0.01	0.01	0.02	0.02
Mortgage-Backed Bonds Issued	0.37	0.55	0.74	0.78
Other Borrowings	1.79	2.30	2.66	3.30
Other Liabilities	1.76	1.74	1.61	1.77
TOTAL LIABILITIES	96.72	97.14	98.74	100.89
REGULATORY CAPITAL				
Preferred Stock	0.02	0.04	0.17	0.16
Permanent Stock	0.09	0.11	0.13	0.12
Contributed Capital	0.75	0.94	1.23	1.26
Qualifying Mutual Cap. Cert.	0.00	0.00	0.00	0.00
Qualifying Subordinated Deb.	0.12	0.18	0.17	0.20
Appraised Equity Capital	0.25	0.29	0.24	0.20
Net Worth & Income Cap. Cert.	0.49	0.34	0.21	0.19
Retained Earnings (Deficit)	1.56	0.96	(0.89)	(3.03)
TOTAL REGULATORY CAPITAL	3.28	2.86	1.26	(0.89)
TOTAL LIABILITIES & REG. CAP.	100.00	100.00	100.00	100.00

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THRIFTS W/TANG. CAP. <= 0, NET
FINANCIAL RATIOS - STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	1985	1986	1987	9/30/88
Interest Income	9.69	8.90	7.83	7.85
Interest Expense	8.65	7.70	6.73	7.15
Net Interest Inc. (Exp.)	1.04	1.20	1.10	0.70
Other Operating Income:				
Mortgage Loan Fees	0.34	0.31	0.23	0.13
Loan Servicing Fees	0.11	0.11	0.10	0.12
Other Loan Fees & Charges	0.08	0.09	0.08	0.07
Ser.Chgs. & Fees-Trans.Accts	0.07	0.09	0.09	0.09
Service Corps./Subsidiaries	0.14	0.08	(0.09)	(0.08)
Other	0.22	0.19	0.13	0.14
Total Oth. Operating Income	0.96	0.86	0.53	0.47
Operating Expense:				
Officers & Employees Comp.	0.76	0.81	0.79	0.78
Legal Expense	0.03	0.04	0.05	0.06
Office Occ. & Equip. Expense	0.40	0.42	0.41	0.42
Marketing Expense	0.09	0.08	0.08	0.07
Professional Services	0.04	0.06	0.05	0.06
Amortization of Goodwill	0.20	0.25	0.23	0.20
Other	0.62	0.64	0.59	0.56
Total Operating Expense	2.14	2.30	2.21	2.15
NET OPER. INCOME (DEFICIT)	(0.14)	(0.23)	(0.59)	(0.99)
Non-Operating Income:				
Profit on Sale of REO & Other	0.06	0.05	0.05	0.05
Profit on Sale of Investments	0.19	0.28	0.09	0.12
Profit on Sale of Loans	0.32	0.41	0.27	0.16
Amortized Deferred Gains	0.02	0.01	0.01	0.00
Other	0.22	0.18	0.10	0.09
Total Non-Operating Income	0.81	0.93	0.52	0.42
Non-Operating Expense:				
Provision for Losses on Assets	N/A	N/A	1.05	1.63
Loss on Sale of REO & Other	0.11	0.26	0.07	0.06
Loss on Sale of Investments	0.04	0.04	0.06	0.07
Loss on Sale of Loans	0.24	0.56	0.08	0.07
Amortized Deferred Losses	0.06	0.06	0.07	0.05
Other	0.07	0.15	0.15	0.05
Total Non-Operating Expense	0.51	1.08	1.48	1.94
INCOME (LOSS) BEF. TAXES & ADJ.	0.16	(0.38)	(1.54)	(2.51)
Income Taxes (Credits)	0.02	(0.03)	0.01	0.01
NET INCOME (LOSS) BEFORE ADJ.	0.14	(0.35)	(1.55)	(2.51)
Prior Period Adjustments	(0.04)	(0.14)	(0.02)	(0.06)
ADJUSTED NET INCOME (LOSS)	0.10	(0.49)	(1.57)	(2.57)

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THRIFTS W/TANG. CAP. <= 0, NET
QUARTERLY STATEMENTS OF OPERATIONS
(Dollars in Thousands)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	$ 4,608,674	$ 4,613,057	$ 4,740,445	$ 4,837,508
Interest Expense	4,091,770	4,186,017	4,254,176	4,489,586
Net Interest Inc. (Exp.)	516,904	427,040	486,269	347,922
Other Operating Income:				
Mortgage Loan Fees	118,341	65,225	90,522	72,766
Loan Servicing Fees	65,116	63,622	72,252	75,460
Other Loan Fees & Charges	39,064	38,400	39,546	40,806
Ser.Chgs. & Fees-Trans.Accts	54,631	54,157	55,938	60,769
Service Corps./Subsidiaries	(210,991)	(14,243)	(48,712)	(75,077)
Other	87,445	84,661	92,267	80,200
Total Oth. Operating Income	153,606	291,822	301,813	254,924
Operating Expense:				
Officers & Employees Comp.	462,065	464,227	471,149	472,865
Legal Expense	35,406	34,164	38,202	40,975
Office Occ. & Equip. Expense	246,103	248,601	250,129	254,471
Marketing Expense	50,629	41,083	46,959	40,184
Professional Services	35,087	30,416	38,002	40,328
Amortization of Goodwill	180,337	120,410	122,445	126,990
Other	345,944	328,913	342,119	343,021
Total Operating Expense	1,355,571	1,267,814	1,309,005	1,318,834
NET OPER. INCOME (DEFICIT)	(685,061)	(548,952)	(520,923)	(715,988)
Non-Operating Income:				
Profit on Sale of REO & Other	40,881	26,850	39,126	27,274
Profit on Sale of Investments	32,770	62,715	40,323	109,094
Profit on Sale of Loans	91,901	119,856	88,645	73,074
Amortized Deferred Gains	3,226	1,509	1,179	1,877
Other	84,606	27,352	85,701	56,426
Total Non-Operating Income	253,384	238,282	254,974	267,745
Non-Operating Expense:				
Provision for Losses on Assets	984,261	1,034,387	971,951	938,899
Loss on Sale of REO & Other	41,990	27,639	40,516	40,646
Loss on Sale of Investments	22,941	15,516	40,058	72,510
Loss on Sale of Loans	59,752	56,045	47,784	25,169
Amortized Deferred Losses	40,313	32,166	30,511	33,935
Other	64,990	25,716	39,348	33,622
Total Non-Operating Expense	1,214,247	1,191,469	1,170,168	1,144,781
INCOME (LOSS) BEF. TAXES & ADJ.	(1,645,924)	(1,502,139)	(1,436,117)	(1,593,024)
Income Taxes (Credits)	(22,284)	(9,174)	11,047	12,977
NET INCOME (LOSS) BEFORE ADJ.	(1,619,150)	(1,488,780)	(1,447,160)	(1,605,984)
Prior Period Adjustments	(23,363)	(13,668)	(14,304)	(74,351)
ADJUSTED NET INCOME (LOSS)	$ (1,642,513)	$ (1,502,448)	$ (1,461,464)	$ (1,680,333)

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THRIFTS W/TANG. CAP. <= 0, NET
FINANCIAL RATIOS - QUARTERLY STATEMENTS OF OPERATIONS
(As a Percent of Average Assets)

	12/31/87	3/31/88	6/30/88	9/30/88
Interest Income	8.21	7.65	7.86	8.02
Interest Expense	7.29	6.94	7.06	7.45
Net Interest Inc. (Exp.)	0.92	0.71	0.81	0.58
Other Operating Income:				
Mortgage Loan Fees	0.21	0.11	0.15	0.12
Loan Servicing Fees	0.12	0.11	0.12	0.13
Other Loan Fees & Charges	0.07	0.06	0.07	0.07
Ser.Chgs. & Fees-Trans.Accts	0.10	0.09	0.09	0.10
Service Corps./Subsidiaries	(0.38)	(0.02)	(0.08)	(0.12)
Other	0.16	0.14	0.15	0.13
Total Other Oper. Income	0.27	0.48	0.50	0.42
Operating Expense:				
Officers & Employees Comp.	0.82	0.77	0.78	0.78
Legal Expense	0.06	0.06	0.06	0.07
Office Occ. & Equip. Expense	0.44	0.41	0.41	0.42
Marketing Expense	0.09	0.07	0.08	0.07
Professional Services	0.06	0.05	0.06	0.07
Amortization of Goodwill	0.32	0.20	0.20	0.21
Other	0.62	0.55	0.57	0.57
Total Operating Expense	2.42	2.10	2.17	2.19
NET OPER. INCOME (DEFICIT)	(1.22)	(0.91)	(0.86)	(1.19)
Non-Operating Income:				
Profit on Sale of REO & Other	0.07	0.04	0.06	0.05
Profit on Sale of Investments	0.06	0.10	0.07	0.18
Profit on Sale of Loans	0.16	0.20	0.15	0.12
Amortized Deferred Gains	0.01	0.00	0.00	0.00
Other	0.15	0.05	0.14	0.09
Total Non-Operating Income	0.45	0.40	0.42	0.44
Non-Operating Expense:				
Provision for Losses on Assets	1.75	1.72	1.61	1.56
Loss on Sale of REO & Other	0.07	0.05	0.07	0.07
Loss on Sale of Investments	0.04	0.03	0.07	0.12
Loss on Sale of Loans	0.11	0.09	0.08	0.04
Amortized Deferred Losses	0.07	0.05	0.05	0.06
Other	0.12	0.04	0.07	0.06
Total Non-Operating Expense	2.16	1.98	1.94	1.90
INCOME (LOSS) BEF. TAXES & ADJ.	(2.93)	(2.49)	(2.38)	(2.64)
Income Taxes (Credits)	(0.04)	(0.02)	0.02	0.02
NET INCOME (LOSS) BEFORE ADJ.	(2.89)	(2.47)	(2.40)	(2.66)
Prior Period Adjustments	(0.04)	(0.02)	(0.02)	(0.12)
ADJUSTED NET INCOME (LOSS)	(2.93)	(2.49)	(2.42)	(2.79)

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The **Chairman**. That's very helpful to us and particularly with the understanding of the work that you've kindly offered to do at the outset. We've taken you up on that offer to give us some things that would be very helpful to our work.

I'd like to also say that we want to move as rapidly as we can. I know you're in the midst of a lot of other activities, but we'd like to get that information as quickly as we can. I know you will do your best.

Let me go through just a series of questions with you.

CBO indicates in their staff memorandum to the House Ways and Means Committee that allowing the administration's borrowing to go off-budget could "be even more damaging to the integrity of the unified budget, the meaning of the budget deficit, and the deficit reduction efforts" than would exempting the bailout from Gramm-Rudman. You just touched on that.

But then you go on to say that the issue of appropriate budgetary treatment is ultimately not a technical question to be resolved by OMB or CBO, but rather a political question. You further suggest that Congress should specify in legislation how to treat this borrowing.

Now, I'm going to preface the question I want to pose by saying that I'm not necessarily advocating exempting the bailout from Gramm-Rudman. My mind is still open on that issue. But we are operating under a set of technical budget concepts that are reasonably well established.

Isn't it part of CBO's mission to inform the Congress of the part of any legislation that impacts the federal budget?

Mr. **Blum**. Yes, it is.

The **Chairman**. Well, why wouldn't it follow that you should be under as much obligation to make a clear policy recommendation because it has to do with treatment of the process as you would to give us a formal best judgment on numbers?

RESOLUTION FINANCING CORPORATION IS NOT AN OFF-BUDGET GOVERNMENT ENTITY

Mr. **Blum**. Well, our judgment right now, based on the reading of the legislation and using the budgetary concepts that were set down over 20 years ago by the President's Commission on Budget Concepts, is that the Resolution Financing Corporation is not an off-budget Government entity, but is in fact a Government entity that ought to be included in the budget.

We reached that conclusion because, first of all, it does not appear to us to be a privately owned entity. That is the one criterion that has been used in the past for excluding these Government-sponsored enterprises from the budget.

This Resolution Financing Corporation would be created by the Government for the sole purpose of borrowing funds and transferring them to a Federal agency, in this case the Resolution Trust Corporation. The Resolution Financing Corporation's actions would be controlled by the regulations, orders, and directions prescribed by this RTC oversight board, which would consist of three federal officers.

Furthermore, the Resolution Financing Corporation cannot pay dividends to or otherwise benefit its supposedly nominal owners, which would be the Federal Home Loan Banks. The Federal Home Loan Banks have to put up some money. There's no chance that they will ever get any dividends back.

The bill also gives the Resolution Financing Corporation the authority to levy and collect assessments on federally insured thrifts, functions that are normally reserved for the Government agencies.

I think, in any case, that what distinguishes this from FICO is that it is the Treasury, and not these assessments on savings and loans, that will finance the bulk of the borrowing by this funding corporation. That wasn't true for FICO. It clearly is true for the Resolution Financing Corporation.

Now essentially that would be the judgment that we would give to the committee. Our experience in terms of scorekeeping, however, has been that under the Congressional Budget Act the ultimate scorekeepers in fact are the Budget Committees, who have to advise the parliamentarian on how each bill stands vis-a-vis a budget resolution or the like.

The CHAIRMAN. I appreciate that. It seems to me, though, that you just made a very strong case in looking at the history and the practice and the theory behind how we make the decisions that this part of the plan really should be thought of as on-budget. It really falls within the parameters of the Federal Government. It is a Federal Government activity and obviously that creates the problem of how to navigate it around the Gramm-Rudman-Hollings discipline? Isn't that really the problem?

Mr. BLUM. That's exactly the crux of the problem. That is why I conclude that ultimately it's a policy matter that you're going to have to wrestle with, together with the Budget Committees and the other Members of the Congress.

I would point out again that the essential reason that we would prefer to have the spending of this money on-budget is simply that this is recognizing a loss that the Government has incurred in the past and, it seems to me, that ought to show up on our books. If we had been recognizing this loss as it occurred, for example, over time, we would have been having higher deficits the last several years.

The CHAIRMAN. Isn't it fair to say, going back to table 1, using the projections out through 1999, that the taxpayer is being asked to sign up for $84 billion worth of expenditures to float this plan?

Mr. BLUM. That's entirely correct.

The CHAIRMAN. So, I gather you're saying that if the system broke down in such a way that the taxpayers are being asked to now produce $84 billion over 11 years, that it ought to be recognized in the budget because we're putting the arm on them to pay this money. Isn't that essentially what you're saying?

Mr. BLUM. That's exactly so.

The CHAIRMAN. And, of course, it may be higher. The system and the way it's engineered is open-ended.

Mr. BLUM. That's true. And, for example, as you discussed with Mr. Darman yesterday, if interest rates in fact turn out to be higher, as for example CBO projects them to be higher over the next several years, then the interest calculations that are on this table 1 will turn out to be too low and would have to be raised.

For example, in the formal statement we said that if we were to substitute our assumptions for those of the administration's, how would that affect these numbers? In the case of the interest to be paid on this $50 billion of REFCORP bonds over this period of time, we calculate that the cost would be roughly $8 billion higher than the administration's estimate. But we also would add to that the interest that would have to be paid on this added Treasury borrowing, this $84 billion, and that would be at least another $13 billion higher than we've shown here.

On the other hand, there is a bright side, I suppose, if we went——

The CHAIRMAN. We've been through ten hearings now and getting to the bright side is a wonderful moment in this proceeding. I don't want anybody to miss it, so give us the bright side.

Mr. BLUM. Well, this is only a little bright side. I was going to observe——

The CHAIRMAN. I had a hunch that might be the case.

Mr. BLUM. In buying zero coupon bonds, as the administration proposed, higher interest rates mean that it would cost less than the $6 billion that they calculated and that they show in their books. Using our interest rates, the costs would only be $4 billion. It's a little brighter. Not much.

So the net effect of substituting our interest rates would be to add roughly $20 billion to table 1.

The CHAIRMAN. Well, $20 billion even in this town is a lot of money.

It seems to me that what I hear you saying—and obviously there's a sensitivity here about policy questions having to do with Gramm-Rudman-Hollings and whether we were to consider seriously an exemption to that or not—is that you think that the spending impact of this plan ought to be on budget.

Can you give us a sense, without taking a position on it but just your professional sense, as to what the pluses and minuses would be if we were to do this on budget and apply an exemption to Gramm-Rudman for this extraordinary problem? What are the negatives associated with that?

Mr. BLUM. Well, there would be no substantive difference. It's simply an accounting change that I think has the advantage of being up front in terms of what the actual costs are that have been incurred by the Federal Government by virtue of having this deposit insurance program.

There are conceptually at least two different accounting ways that I can think of to do this. One, which I've already suggested is taking the administration's proposal but, instead of setting up a separate funding corporation, putting it on-budget and letting Treasury fund it. If we allowed that borrowing to take place over the time that they've indicated—$10 billion in 1989, and $25 billion in 1990, and $15 billion in 1991—it would all show up as adding to outlays and the deficit. But then I would suggest excluding those amounts from the Gramm-Rudman deficit calculations.

An alternative way of doing that, I suppose, would be to record all of the $50 billion in fiscal year 1989. In that way you wouldn't have to amend Gramm-Rudman because you're not playing in that game. We're not playing any games under Gramm-Rudman now in 1989.

The CHAIRMAN. You would be dumping the cost in fact into the previous fiscal year in effect. Is that right?

Mr. BLUM. That's right. That would be analogous, for example, to banks and other financial institutions writing down the value of their assets and taking a loss in only one quarter. In essence, that's what we would be doing here—recording that loss that we've already experienced.

The CHAIRMAN. I've noticed too in following financial markets over the years that when a company or bank has to take a negative financial hit, they handle it in a direct financing way. Usually, their stock values go up because there's the feeling that they've addressed the problem. It's behind them, and they've been straightforward about it. I've found that market psychology tends, on balance, to be more positive with the direct approach. I don't say that would necessarily apply here, but that's my impression.

Mr. BLUM. Well, I think that's a point well taken, Mr. Chairman, that those people who have a deficit illusion, who think that the deficit that we record has real economic meaning, would more easily understand what we were doing if we recorded the $50 billion all in 1 year instead of spreading it over 3 years. Those people might think that we really were incurring economic deficits of that size if we spread it over time. So actually that's one good thing to be said for doing it all at once.

The CHAIRMAN. Well, I think that's a very interesting idea that's worth consideration.

If I may, I want to go back to one other thing because I'm not sure I tied it down quite the way I intended to when we were on that subject.

Going back just for a minute to table 1 and going back to the $84 billion posted figure of Treasury borrowing, you had said that in effect that's the part that we would be signing, the taxpayer or the Federal Government in general would have to pay, but that that is an open-ended number.

Is it your understanding that if we were to enact the bill as exactly as written, there would be no limit to the amount of money? If we passed the bill as is, have we in a sense signed a blank check that automatically the spending would be done to meet the cost no matter how high the cost is, absent some other action by the government?

UNLIMITED AUTHORIZATION AS THE BILL IS WRITTEN

Mr. BLUM. Well, essentially it is an unlimited authorization in the bill as it is written, but I would observe that it is presumably subject to annual appropriation action. So there is, I guess, an annual control device over that, but it does also appear that these payments that the Secretary of Treasury will make are fairly mandatory in nature.

The CHAIRMAN. I'm told by staff that this kind of appropriation, however, may be different in kind in that it may be a mandatory appropriation. It's like an entitlement. In other words, if the bills are there they have to be paid.

Yes, Congress has to appropriate it but it's not as if they have a choice to not appropriate it. Is that right?

Mr. BLUM. I think that's correct. I would agree with that. I might add, though, that having the annual appropriation does add a bit of the uncertainty to these $50 billion in bonds. This is another reason why a premium would be charged.

The CHAIRMAN. Do you find any cap in this bill on the cost that could be incurred with respect to new cases that will be coming down the track?

Mr. BLUM. No.

The CHAIRMAN. So it seems to me that we're at a very important point in terms of the detective work on the financial side of this plan. That is that the current estimate, based on the administration's plan, is the taxpayer or the Federal Government would have to chip in $84 billion over the next 11 years. That's only an estimate based on optimistic economic assumptions and it could well be higher.

To the question of how much higher could it be, in essence, the sky is the limit. We really don't know. It could be any figure. The mechanics of the system are such that if we passed this bill exactly as it is today, we are locking the Government in to pay that figure no matter how big it is. There's an automatic mechanism by which those bills will be paid in the future no matter how high they go.

Mr. BLUM. Well, Mr. Chairman, I don't see that there's any alternative to that. These are losses that have occurred and the reason for moving fairly quickly—it seems to me—is to prevent these losses from getting even larger in the future.

The CHAIRMAN. There's something to what you say. Whatever the cost is, we're going to have to pay it. On the other hand, depending upon the most accurate assessment that we can make of the future cost, how we choose to handle it now might very well be different. If it turned out that the cost was not $84 billion but more likely was going to be $120 billion or $150 billion—I just use those numbers hypothetically—it might well be that we might change the plan in certain basic ways.

I also think that there's a question of honesty in budgeting and honesty in terms of being forthright with the American people. I think the plan has been presented thus far has never at any time suggested that we were putting their name on a blank check. I think the plan has been presented in a way where this solution captures the problem and this is the cost as we see it. But, in fact, when you dig into it, the cost could be substantially higher, and the mechanism that's being proposed is one that says, look, we're going to have to deal with it so we're in effect asking you to sign this blank check today. We can't fill in the numbers. We're going to put the numbers in over the next 30 years, but we'd like you to sign the blank check today. Then, as we need to spend the money there will be a mechanism that, in effect, automatically taps the taxpayer to spend whatever that amount turns out to be.

One of the problems with that is if you don't have ways to measure and monitor and restrain any kind of an open-ended spending process, the costs for a lot of reasons tend to get higher. In other words, I think we ought to have a way of setting the outer bounds as to how much is going to be spent so that we have an ability to come back and revisit the issue if we find that some of the internal mechanisms of the plan didn't work as they were advertised. And if we find that we're veering off in a direction that wasn't anticipated, I want us to be in a position to be able to reach in and make maybe major adjustments to keep the ultimate cost to the taxpayer from ballooning.

Mr. BLUM. I understand your concern. I think those are points well taken. But I would point out that there is a great need to move quickly to resolve the 500 or so thrifts that are now insolvent, or soon-to-be insolvent, so as to put that cost behind us. Equally important is moving ahead with regulatory reform so that we don't get this problem in the future. I think that a very important part of reform is raising the capital standard. This is critical from a deposit insurance point of view, because if you have a higher stake in these thrifts, we're not likely to get to the kind of insolvencies that we're facing right now.

The CHAIRMAN. I fully agree with you there.

Senator Pressler, if I may, this has been an area that you have raised previously and I'd like to, before yielding to you, sort of review just very briefly the discussion that we are just in the middle of here because I think it's something that you may want to inquire about yourself.

I've asked the staff to get this table 1 laid out here so you can see a spread sheet that CBO has done on the sources and uses of cash to finance this plan and what it does is this sheet looks at the next 11 years, from now through 1999, and if you go out to the column all the way to the right what it does is it shows a total expenditure of dollars over that 11-year period of $205 billion, a figure that shows about halfway down as a total. Then, of course, above that they show the various directions from which the money would go, how it would be spent.

Then down below they have the sources of cash as to where the cash would come from to meet those expenses that are lined up above.

If you look under the sources of cash down the third number from the bottom, Treasury borrowing over the 11-year period, you'll see the figure $84 billion. Do you spot that figure?

Senator PRESSLER. Yes.

The CHAIRMAN. You asked the other day a question as to whether these debts should be thought of as part of the Federal deficit. I'm paraphrasing your remarks. What has been identified here today by CBO is that the number of dollars the taxpayers would, in effect, be expected to pay under this plan as it's constituted over that 11-year period is that $84 billion.

Obviously, there are more expenses that go on out into the 20 years beyond that into the next century, but for the first 11 years that's the price tag to the taxpayer.

But what Mr. Blum has just said is that that is an estimate and the number in fact could be substantially higher. If interest rates, for example, are higher, the number goes up.

He's also testified that his understanding of the nature of how the plan works is that if we were to enact the bill exactly as it is today we set up an open-ended authority. Once we enact it, we've signed a blank check and the numbers will get filled in as we go down the line.

We were just in the process of trying to figure out if there's some way we can establish some caps so that we at least maintain some outer bounds as to how much the taxpayers are going to have to pay. At a minimum the caps would bring the issue back to us so that we could take a look at it and see why the numbers were higher than anticipated and what we might do to squeeze them down or limit that hit to the taxpayers.

I don't recall that we have seen in this direct a way the $84 billion figure. That is in addition to the $50 billion that would be borrowed in these zero coupon bonds and the $7 billion in FICO bonds. The remainder and any money not otherwise produced from those sources comes from the people of South Dakota and Michigan and the other 48 States.

So with that, I think if you want to perhaps inquire at this point I'd be happy to yield to you.

Senator Pressler. I thank the chairman very much for restating my question.

My question relates, for example, to when I'm speaking to the Sioux Falls Kiwanis Club, which I do occasionally, and someone asks me what does this really do to our national debt. How do you explain to the Kiwanians what it does to our national debt? This is indeed the point here, that this is an off budget item, as I understand it, under the administration's plan, but it is an open-ended thing, is that correct? How do you explain what this does to the national debt, first of all?

EFFECT ON THE NATIONAL DEBT

Mr. Blum. Well, first of all, Senator, it obviously adds to the national debt; there is no question about that. It is recognizing now a loss that in fact has already been incurred by the Government, and it's making good on that loss. So, yes, it does affect the national debt.

I guess I would point out as well that if you take our suggestion and have the Treasury do the borrowing, rather than some kind of funding corporation, you could add the $50 billion to the $84 billion and get a number that would represent the taxpayers' contribution. In any event, the taxpayer is paying for the bulk of the cost of this plan.

Our calculation, for example, is that over the entire life of the plan the Treasury is going to account for more than 70 percent of the resources used to finance the administration's program. There shouldn't be any question about that.

Senator Pressler. I do have a further question. In your prepared statement you indicate there are striking similarities between the Resolution Financing Corporation and the Farm Credit System Financial Assistance Corporation. I think this is on page 13, the last paragraph—on page 13.

Now the Farm Credit System Financial Assistance Corporation is included in President Reagan's 1990 budget as a Federal agency and you also would score the new Resolution Financing Corporation, REFCORP, as a Federal agency.

Will you please clarify this with your statement in the last paragraph on page 10 that indicates the consequences of putting the plan on budget?

Mr. BLUM. This goes to the point, Senator, that I think you may have been raising yesterday in quoting from an article that Martin Feldstein wrote in the Wall Street Journal. Essentially, the point that Mr. Feldstein was making is that the effect of borrowing this $50 billion to finance the resolution of the savings and loan problem does not have a macroeconomic impact. And we would agree with that analysis completely.

It's on that basis that we reached the conclusion that an appropriate way of proceeding could be one of two ways. One way would be to do it all on-budget with the Treasury doing the borrowing, but to exclude the $50 billion from the Gramm-Rudman-Hollings deficit calculations. Excluding it would be the same as excluding asset sales and loan prepayments from those calculations, as is done now, because essentially they're the same thing.

An alternative way of doing it, as we discussed earlier this morning, would be to show the $50 billion as a one-time adjustment to the budget all in 1989. This would recognize the losses that have in effect already been incurred in the same manner that banks, for example, write down their assets when they recognize losses that have occurred and take a hit on their income.

Senator PRESSLER. Actually, it wasn't Feldstein's article. It was another article in the Wall Street Journal which Mr. Darman hadn't read, although it called him the smartest guy alive when it came to figures.

Mr. BLUM. Was that the one that talked about——

Senator PRESSLER. The one that talked about when you put it off budget and then you bring in the revenues, it actually shows the budget as having a lower deficit.

Mr. BLUM. That was Alan Murray's article that appeared on of February 22.

Senator PRESSLER. That's the ultimate in deft of hand accounting, isn't it?

Mr. BLUM. Yes, it is.

Senator PRESSLER. Actually, it shows that if this plan were enacted it lowers the deficit for fiscal year 1990, doesn't it?

Mr. BLUM. You're exactly right, and the article is quite correct and it does give you this anomalous result.

Senator PRESSLER. And the reason for that is you're taking it as an off budget item, infusing it into the on budget item so that anybody can claim that we have reduced the deficit.

Mr. BLUM. That's right.

Senator PRESSLER. That's what I'm getting at in this whole thing. I think we need truth in lending and truth in legislative budgeting here. But that article fascinated me because it illustrated all that I think is wrong with the way we play with budgetary figures up here. I think it's a classic article for students of the Federal budget to read and maybe Senators, that this savings and loan program that the President has proposed will actually show a reduction in the deficit for the first fiscal year.

Mr. **Blum**. That's the way the administration's accounting works out. We would disagree with that accounting.

Senator **Pressler**. I understand. But I think that's very important for everybody in the country to know and I'm not saying I'm against the President's plan for that reason. Perhaps you would like to do some additional written response on that particular article, which I put in the record yesterday. I think it's a fascinating little article that the Wall Street Journal did. Who was that by? I had it yesterday.

Mr. **Blum**. Alan Murray.

Senator **Pressler**. Yes.

Mr. Chairman, that's the point I'm making. That's the bottom line or that's the question I'm trying to get to, as they say in law school class.

So you agreed that——

Mr. **Blum**. I fully subscribe to the points made in that article.

Senator **Pressler**. And how can we avoid that conclusion?

Mr. **Blum**. Well, we've talked about that this morning in the sense of an alternative way of putting these transactions on the budget. There are at least two different ways that that could be handled in an accounting sense. There are several advantages to doing so. One is that it will cost the taxpayer less, because we won't have to pay premiums for the interest that would be charged on the $50 billion in bonds to be issued by REFCORP.

Second, it seems to me that it could be done much quicker than setting up some kind of a shell corporation off-budget. It would also allow the Treasury to finance that borrowing in whatever manner it thought best, the way it finances the rest of the budget deficit.

And it seems to me that a good case can be made—and that's why I made an allusion to Dr. Feldstein's article—as to why this should not add to the budget deficit problems that we are now facing for 1990 under the Gramm-Rudman-Hollings Act.

Senator **Pressler**. OK. Thank you, Mr. Chairman.

The **Chairman**. I think that's very important testimony that we've been getting here and Senator Pressler has been trying to nail this down over a period of several hearings——

Senator **Pressler**. I finally got somebody to say it. I'm sure it's right, but you're the first man who has been willing to say that of all the witnesses that sat at that table.

The **Chairman**. I want to take you through one more detailed questions and then we'll submit the rest of the questions for the record because we have two other witnesses before us this morning.

So, let me go through this carefully with you. The administration has consistently said that its plan will only cost the taxpayers about $40 billion over the next decade. A preliminary Senate Budget Committee analysis released Wednesday suggests that even if you accept the administration's numbers and assumptions, there appears to be far more taxpayer money involved. The Budget Committee's analysis suggests that $76.8 billion in Treasury funds are involved.

Secretary Brady was asked the other day at a hearing about this number, and he said that he would have to check on it. So, presumably that check is being done by Treasury.

But I wonder if you would go through the arithmetic with me now in this room.

I'm taking the 10 year numbers off the detailed tables provided as background on the plan by OMB. It seems to me—by the way, this work has been prepared by Senator Sasser, who would be here right now to go through this himself, but we have discussed it so I'm going to present it for him.

ANALYSIS OF THE 10 YEAR CALCULATIONS

Mr. BLUM. Mr. Chairman, perhaps to save you some time and the difficulty of going through all of these complex calculations, I can explain very quickly how that number was arrived at and how it compares to the numbers that are presented in table 1. I think that's the pertinent point.

Essentially we are doing the same kind of calculation, except that the $77 billion number includes one figure that we did not and it excludes one figure that we included. The figure that is not in the $77 billion is, looking on table 1, the $16 billion of interest on Treasury borrowing. That is what we've added to the administration's calculations that we discussed earlier in the meeting.

So if you added $16 billion to Senator Sasser's $77 billion, that's a way of approaching our number. But it also includes $9 billion—$8.8 billion in fact—for the recapitalization of FSLIC, which we do not show on table 1.

And the reason we don't show it is because that's not real cash. That's just a line of credit, in effect, that Treasury would be giving to FSLIC in building up their balance sheets. It's not really cash.

So if I make those two adjustments to Senator Sasser's $77 billion, I add $16 billion and I take away $9 billion. We thus arrive at the figure that we've talked about at length this morning, which is the $84 billion on table 1.

The CHAIRMAN. I think I'm with you up to that point, but didn't we also indicate that that $84 billion did not necessarily take account of any other cost items that might fall in here, apart from economic assumption changes?

Mr. BLUM. That's correct.

The CHAIRMAN. Aren't there other things kicking around that can boost that figure higher?

Mr. BLUM. Well, the only thing that would boost the $84 billion higher, that is included in Senator Sasser's staff calculations, is this $8.8 billion of recapitalizing FSLIC. That is shown on the administration sheet. For example, in attachment A in Mr. Darman's testimony yesterday, it shows up way down at the bottom of that table under the line called "Balance for the new fund."

The CHAIRMAN. But what is your position on whether or not that item should be included?

Mr. BLUM. We did not include it here because it's not real cash. No cash is being exchanged. It's really more in the way of a promissory note of the Treasury that will be on the books of this new savings——

The CHAIRMAN. Who pays it?

Mr. BLUM. Well, if it has to be used, it will be paid by the Treasury—the taxpayer.

The CHAIRMAN. So, what would you call that, a contingent liability?

Mr. BLUM. It's a contingent liability.

The CHAIRMAN. But presumably it's there with the expectation that it may be needed.

Mr. BLUM. That it could be used in the future.

The CHAIRMAN. I think you could make a fair argument that says you want the direct cost plus the contingency that's being established which in turn is a direct hit to the Treasury which is in the second category.

Mr. BLUM. You could do that.

The CHAIRMAN. That would take us up to roughly $93 billion, would it not?

Mr. BLUM. That's correct. So what Senator Sasser didn't include is the $16 billion that we have included up above under "Uses of cash, Interest on the Treasury borrowing." It is being used to finance—remember that there were three items—the net outlays by FSLIC and this RTC corporation over this period of time. That sum adds to the deficit: the interest cost that the Treasury would be paying on the Resolution Financing Corporation bonds, the $50 billion in bonds, plus the cash that the Treasury has to put up to pay off these FSLIC notes. These amounts were not included in Senator Sasser's calculations.

The CHAIRMAN. Now it seems to me, having come this far, that again this latest discussion centers around using the administration's economic assumptions about the dramatic drop in interest rates and a pretty strong buildup in deposit levels at savings and loans and deposit growth.

As we have covered earlier in the testimony, if it turns out those economic assumptions go the other way or they are more adverse, these numbers really start to grow and we have agreed today that we will do a sensitivity analysis, that you will do one for us, that looks at inserting into the calculations the interest rate forecasts that CBO is using as its best projection of the future to see how much that takes and moves these numbers around.

Mr. BLUM. That's right. And as I stated earlier, right now, if we just inserted our own CBO interest assumptions instead of the administration's, the interest cost by our calculations on net would increase by approximately $20 billion.

You also talked yesterday about what would happen to the assessments on the S&Ls if we didn't get the deposit growth of 7 percent annually, and you had the answer. What if it were only 4 percent, for example; and I believe Mr. Darman's response was that it would be approximately $5 billion lower. We would agree with that calculation. If there were zero growth over this entire period, which in fact some people assume, then it would be $10 billion lower.

The CHAIRMAN. Now your estimate of a higher cost of $20 billion if you use the interest rate assumptions that you are now using in your other calculations, just your everyday work, over what time period would that occur? Is that over the 11 years?

Mr. BLUM. That's right.

The CHAIRMAN. OK. So you have an 11-year cost potentially here just on the interest rates being at a level that CBO anticipates they will be of a $20 billion add-on. So if you're using the number that Senator Sasser and the Budget Committee developed of roughly $93 billion for the taxpayer cost of the plan using the administration's assumptions, if we shift just that one assumption, just the interest rate assumption, then presumably that adds in effect $20 billion over the 11 years and that would kick you up to $113 billion. Is that correct?

Mr. BLUM. That's right.

The CHAIRMAN. And I think that point sort of stands by itself, but then if you were to take it one step further with the lower buildup of deposits in savings and loans, the one that Mr. Darman spoke about yesterday, did I understand you to say that that would end up working through the calculation to add another $5 billion of cost?

Mr. BLUM. That's correct, if the deposits were to grow on the average of say 4 percent a year over this time period.

The CHAIRMAN. Rather than 7 percent?

Mr. BLUM. That's right.

The CHAIRMAN. Then that would add another $5 billion over the same period. So that would take us up to $118 billion.

Now I want to hasten to add that doesn't mean it's going to be $118 billion. It may not be that bad. It may be worse than that. But just with the adjustment of those two variables in the economic assumptions which are very central economic assumptions, we see this cost to the taxpayer over 11 years potentially in a range of $118 billion if we take just those two changes.

One of our difficulties here is that we want to be very careful and very prudent and we want to be fair and we want to work with the administration in sizing the financial requirements of this package.

But if in fact we were looking at something that's more in the range of $118 billion cost to the taxpayers over 11 years, then it would be my thought, Senator Pressler—and I'll say this to my other colleagues when we can chat with them about it—that we make sure that we have handled the construction of the financing side of the plan in a way that really can deal effectively with what is perhaps a more likely set of possibilities in terms of what the real costs are apt to look like.

I also think—I feel very strongly, as Senator Pressler does, that I want to have us be as up front as our knowledge enables us to be with the American people right now as to exactly what the dimensions of this problem are and the degree to which we are obligating them for the future either with a blank check or with a signed check with their name on it that we put some parameters around.

But it seems to me at a minimum, when you go back to Sioux Falls, that you ought to be able to have some confidence in the answer you give people when they ask the tough questions, as they do to me out in Flint, MI and other places, I want to be able to give answers that I have confidence in, that I believe are right.

That's very helpful to us. Senator Pressler, do you have anything else that you want to raise with this witness?

Senator PRESSLER. No, thank you very much.

The CHAIRMAN. Mr. Blum, we're going to give you some other questions for the record. The work you've done has been very helpful. I appreciate the work that you've agreed to do to help us in the next week or two. We thank you and appreciate your testimony this morning.

Mr. BLUM. Thank you very much, Mr. Chairman.

The CHAIRMAN. Now the committee will take about a 10-minute recess and then we will start with our next two witnesses, but we will recess for a period of about 10 minutes.

[Recess.]

Question: In your estimates of the uses and sources of cash under the Administration's plan, you make no allowances for the tax losses associated with the FSLIC's 1988 merger assistance and future assistance agreements, or for the tax deductibility of insurance premiums by profitable thrifts. What do you estimate the effects of these tax benefits are on Treasury cash needs, including interest on Treasury borrowing?

Answer: CBO's estimates do not incorporate any effects of the tax deductibility of the insurance premiums for profitable thrifts. The premiums are a deductible expense to thrifts, which in isolation would reduce thrifts' income subject to the corporate income tax and therefore their tax liability. Several factors may offset this effect, however. First, these thrifts may pass through some of the increased premiums to their customers, by either raising interest rates for loans or reducing interest rates on deposits. This passthrough is made more likely by the Administration's plan to increase the insurance premiums for commercial banks as well as thrifts. Second, firms with products that compete with insured deposits might experience an improved competitive position and higher profits. As a result of these offsetting effects, we do not expect increased insurance premiums to have a significant effect on aggregate corporate profits or income tax receipts.

The Joint Committee on Taxation (JCT) estimates that, as a result of FSLIC-assisted mergers during calendar year 1988, expected corporate income tax receipts will be reduced by $6.9 billion over the 1988-1994 period. The year-by-year revenue effects are as follows:

Effect of FSLIC-Assisted Mergers in 1988
on Corporate Income Tax Receipts
(By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993	1994	1988-1994
Change in Receipts	-0.1	-1.2	-1.3	-1.1	-1.3	-1.0	-0.9	-6.9

We estimate that any Treasury borrowing to fund these revenue losses would generate $0.2 billion in debt service in 1990 and $2.1 billion over the entire projection period through 1994.

Further revenue losses are possible from assisted mergers concluded during 1989, after which the special tax rules relating to assisted mergers are scheduled to expire. CBO has asked the Joint Committee on Taxation to investigate this 1989 effect as well. At this time, we cannot estimate the revenue loss from these 1989 deals or the effect on Treasury borrowing. The calculation is difficult partly because it is not known what form each assisted merger will take. In addition, because the tax benefits were reduced beginning January 1, 1989, data for 1988 is not directly relevant.

The CHAIRMAN. The committee will resume.

Let me invite those in the room to find a seat.

I want to thank the witnesses for their patience. We are pleased to have both of you here today.

I have previously announced your presence and background. So, what I would like to do is to move directly to your statements. We will make your full statements a part of the record, and what I would like you to do in the interest of time—and other Senators may come in and out because the Tower nomination is on the floor, as you know, but I would like for you to summarize the key parts of your testimony and the issues that you think are really the most central ones. Particularly in terms of any recommendations you have to make to us in how we respond to the proposal from the administration is where I would most welcome and value your suggestions to us.

So, with that, let us start with you, Mr. Ferguson. I would like for you to proceed at this time.

STATEMENT OF WILLIAM F. FERGUSON, CHAIRMAN, FERGUSON & CO.

Mr. FERGUSON. Thank you, Mr. Chairman.

In spite of the dismal performance reported by the thrift industry during the 9 months ended September 30, 1988, a substantial portion of the thrift industry was profitable and adequately capitalized.

The following table sets forth my analysis of the industry by category for September 30, 1988, and I have broken these into categories as follows:

Solvent and well-capitalized: This group consists of thrifts with GAAP capital in excess of 6.0 percent and positive tangible capital. There are 1,202 of these institutions, with total assets of $268 billion.

The second group consists of solvent but undercapitalized institutions. These have GAAP capital greater than 1.5 percent but less than 6.0 percent, but do have positive tangible capital. There are 1,125 of these institutions, with total assets of $665 billion.

The third group in my categories are solvent but marginally viable institutions. There are only 107 thrifts in this category, with total assets of $83 billion. These institutions have GAAP capital greater than 0.0 but less than 1.5 percent, but do have positive tangible capital.

Then finally I have a group that I call insolvent. These are GAAP-insolvent or have negative tangible capital. This group is about the same size as reported by the Treasury Department. There are 501 thrifts in this category, with $248 billion in assets.

The exhibits attached to my full statement contain detailed financial information about each of these industry segments.

To look at the impact of the administration's plan on the thrift industry, let's first discuss the solvent and well-capitalized thrifts.

I do not believe that the plan would jeopardize the continued existence of this group. These thrifts have an estimated capital to total assets ratio of 8.7 to 8.8 percent at September 30, 1988, a tangible capital ratio of 7.53 percent, and adjusted net income of 71 basis points for the nine months ended September 30, 1988.

They obviously constitute a minority of the industry today.

Let's discuss the solvent but undercapitalized thrifts. The plan will jeopardize, in my opinion, the continued existence of this group. The total assets of this group constitute approximately 51 percent of total thrift industry assets. These thrifts have an estimated GAAP capital to total assets ratio of 4.20 percent at September 30, 1988, and a tangible capital to total assets ratio of 2.96 percent.

To bring these institutions to a GAAP capital level of 6.0 percent of total assets would require additional capital of approximately $12 billion, and to bring them to a tangible capital level of 6.0 percent would require approximately $20 billion.

In my opinion, neither capital level is remotely attainable by 1991. For reasons set forth in my complete text, I would support a selective program of capital forbearances to permit institutions in this category—with substantial capital, good earnings prospects, and a clean examination history—additional time to raise capital.

I cannot believe that there is any significant risk to the deposit insurance system or the safety and soundness of the financial system in permitting these selective variances from required capital.

As to the solvent but marginally viable thrifts, I believe that the thrifts classified in this category are, in the aggregate, losing money and are unlikely either to recover on their own or to be able to attract the levels of capital necessary.

I believe the thrifts in this category will, for the most part, be merged or liquidated.

As to the insolvent thrifts, I expect most of the thrifts in this category to be merged or liquidated, and this is clearly where most of the resources provided by the administration's plan will be expended.

Let's discuss the sufficiency of funding to resolve the problem.

First, in the final analysis, the total cost of case resolutions for the thrift industry is just as much a "moving target" today as it has been in the past. The ultimate cost is dependent upon the health of the National economy, future interest rates, the revitalization of regional real estate economies, and the FDIC or FSLIC regulatory approach to case resolutions.

Second, the administration has projected a growth rate of 7.2 percent in insured deposits during the next several years. For reasons set forth in my complete text, this growth rate appears very optimistic, and frankly I will be surprised if there is not a net decline in total deposits as opposed to growth in that time period.

I would also like to discuss three or four additional questions briefly.

Is a separate thrift industry needed?

The Federal savings-and-loan system with deposit insurance was created and developed as an instrument of national housing policy. This system of housing finance has served the Nation and its citizens well. It has been an extremely effective mechanism for implementing our goals of homeownership and decent and safe shelter for the American public. I believe that competition and a diversity of housing finance systems has and will serve our Nation well.

Is the thrift industry viable?

The evidence seems clear that savings institutions which have capital, are well managed, and are not prisoners of a regional depression, have performed well over the last 10 years, in spite of poor regulation and supervision.

Moreover, I see no evidence that the mortgage finance business is inherently unprofitable.

Is the FDIC conservatorship program desirable?

Conservatorship is not a solution to the problems of the troubled industry. At best, it is meanly a means of warehousing problem institutions until the FDIC can organize its staff and financial resources to deal with insolvent institutions. In the absence of an established and effective case resolution process for the FDIC, merely appointing more conservators may worsen rather than ameliorate the situation.

How should the regulatory structure be changed?

The benefits of having the Chairman of the FHLB's report to the Secretary of Treasury are not clear. The Federal Reserve model, which ensures more independence and insulation from administration policies, may well be a preferable system for bank regulators and insurers.

In conclusion and to summarize my views.

The Nation would be well served by maintaining the present housing financing system. Savings institutions have an important role to play in achieving our national objectives. The housing specialized depository institution providing long-term financing is not inherently unstable and unprofitable. Once the surviving industry is recapitalized, it should be both viable and profitable.

Complete compliance with the new capital requirements by June 1991 is unattainable for many viable and profitable institutions, and such an early deadline would be an undesirable and counterproductive policy.

The proposed reorganization of the savings institution regulatory structure is not well thought out. It does not provide independence for the regulators nor protect against future political interference in the decisions and operations of the regulators and insurance agency.

The estimated cost of case resolutions seem reasonable.

The revenue projections for the insurance agency and the assumptions underlying the anticipated cost of financing the assistance are unduly optimistic.

Speedy and vigorous case resolutions are essential, however, to protect the financial health of the 2,000 or more potentially viable and profitable savings-and-loan institutions.

Thank you very much.

The CHAIRMAN. Thank you very much. That is a nice, tight summary.

And I want to say too that I appreciate the fact that you are coming before us again. You have previously appeared here.

I would like, if you would, for the record to just give us a thumbnail sketch of your history and background and what qualifies you to be a person to be here, in a sense, as an expert witness.

Mr. **Ferguson**. Certainly. I would be happy to.

I was a practicing CPA in Tennessee and North Carolina for about 25 years. I took an early retirement in 1982 to move to Texas, primarily because of DFW Airport and it's access to the rest of the country.

During a good part of my tenure as a practicing CPA, I worked with either banks or thrifts in an audit capacity. And in fact, when I left A.M. Pullen & Company, a major regional CPA firm in 1982, I was partner in charge for their financial institutions practice.

Since 1982 I have headed what is now a 40-person financial institutions consulting firm. About 30 or 35 percent of our practice consists of working with the commercial banking industry. The rest of it is thrift industry consulting. Only about 20 percent of our business is in Texas. We think we see the good and the best throughout the entire United States.

We have about 15 CPA's on the staff, and the rest of them are ex-bankers or ex-thrift executives, except for computer programmers.

[The complete prepared statement of William C. Ferguson follows:]

STATEMENT

OF

WILLIAM C. FERGUSON

CHAIRMAN

FERGUSON & COMPANY

BEFORE THE

SENATE COMMITTEE ON

BANKING, HOUSING, AND URBAN AFFAIRS

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INTRODUCTION

Mr. Chairman, Senator Garn, and distinguished Members of the Committee -

I appreciate the opportunity to appear before this Committee and provide my analysis and comments on the savings and loan industry, the current FSLIC crisis, and the Bush Administration's plan to resolve this crisis.

On May 19, 1988, I appeared before this Committee and presented a detailed analysis of the state of the savings and loan industry which was based upon 1987 year-end industry data. In spite of the substantial efforts made by the FHLBB and the FSLIC during 1988 to resolve the industry's problems, a substantial portion of the industry has continued to deteriorate and today threatens the stability of the entire U.S. banking system.

At December 31, 1987, my report showed that 508 thrift institutions were GAAP insolvent. As of September 30, 1988, 437 institutions were GAAP insolvent, even after a substantial number of case resolutions during the first nine months of 1988. In addition, there are many more institutions which, while GAAP solvent, have very low levels of capital and little or no tangible capital. Clearly, the financial resources of the FSLIC are inadequate to resolve the problems of the insolvent thrifts.

The current problems of the thrift industry and the FSLIC can, to a considerable extent, be traced back to structural flaws incorporated into the industry at its inception. However, the current condition of the FSLIC is due to a deterioration of a substantial segment of the industry that has been occurring since the early part of this decade. Moreover, the problems facing the industry today are far different from those of the early 1980's. Instead of negative interest margins resulting from high interest rates, the problems today focus on asset quality. Asset quality problems are likely to be longer lasting than interest margin problems. The massive losses being experienced in a substantial segment of the industry today will continue unless prompt action is taken to resolve the problem cases.

My presentation includes certain financial statements and other data pertaining to the thrift industry. For purposes of the presentation, the data presented pertains only to thrifts which are insured by the FSLIC.

All financial information being presented was derived using computer tapes purchased from the FHLBB. Such tapes contain final financial information through December 31, 1987 and preliminary financial information for the nine months ended September 30, 1988. Since amended reports may be filed by thrifts after preliminary tapes are released by the FHLBB, the financial information included in this presentation may differ somewhat from information prepared by the FHLBB for other forums. However, such differences are not expected to be significant enough to affect the validity of the analysis or conclusions reached in this presentation. The selected financial information and historical financial statements were prepared using the Thrifts Analysis & Forecasting System ("TAFS"tm), a microcomputer software system developed by Ferguson & Company.

My presentation today discusses the Administration's plan for dealing with problems associated with the thrift industry and explores the impact of the plan on the thrift industry. Additionally, it explores the question of whether sufficient funding is provided in the plan to resolve the insolvency of the FSLIC fund and provide a resolution of the substantial number of insolvent or near insolvent thrifts.

THE ADMINISTRATION'S PLAN

The Administration is to be commended for taking prompt action during the early days of its watch to resolve the problems of the FSLIC. The Administration plan is an "emergency package" to ensure the safety and soundness of the financial system in the short run. Essentially, the plan addresses the following needs:

- Funding to resolve a large number of insolvent or unsafe and unsound institutions,
- Gathering higher levels of premium income for the deposit insurance funds,
- Establishing higher capital requirements,
- Strengthening regulatory authority of the insurance funds, and
- Increasing civil and criminal penalties to deter aberrant behavior by financial institution managers and boards of directors.

All of these are laudable and necessary objectives. The plan directs the Treasury Department and the financial regulators to undertake an 18-month study of a wide variety of fundamental issues which affect depository institutions, the insurance funds, and financial markets. Therefore, the next Congress will face a full agenda of "banking" issues and, I am sure, be asked to amend and "fine tune" this rescue package.

STATE OF THE INDUSTRY

At September 30, 1988, the 3,023 thrifts insured by the FSLIC had total assets of over $1.3 trillion. Exhibit I shows the geographical dispersion of these thrifts and Exhibit II presents aggregate financial highlights and historical financial statements.

As in 1987, the industry performed dismally during the first nine months of 1988. Thrifts still operating at September 30, 1988, reported a net loss of almost $5.1 billion. Exhibit I shows financial performance by state and demonstrates the regional nature of the operating losses, particularly in the southwest, being sustained by the industry.

In spite of the dismal performance reported by the industry during 1987 and the nine months ended September 30, 1988, a substantial portion of the thrift industry was profitable and adequately capitalized. Another portion of the industry was profitable but will be required to raise additional capital under the Administration's plan. Still another segment has only marginal capital and is unprofitable. Finally, there is a segment of the industry that is GAAP insolvent or has no tangible capital. My presentation will analyze each segment of the industry.

The following table sets forth my analysis of the industry by category at September 30, 1988:

Category	Number	Assets (Billions)
Solvent and Well-Capitalized	1,202	$ 268
Solvent but Undercapitalized	1,125	665
Solvent but Marginally Viable	107	83 (1)
Insolvent	501	248 (2)
Totals	2,935	$1,264

(1) Includes American of California and Sunbelt of Texas
(2) Excludes certain institutions included in the Southwest Plan and all other case resolutions during the three months ended December 31, 1988.

Exhibit III shows the geographical dispersion of the solvent and well-capitalized thrifts and Exhibit IV presents financial highlights and historical financial statements. A viable and well-capitalized thrift is defined as one that has GAAP capital in excess of 6% and positive tangible capital.

Exhibit V shows the geographical dispersion of the solvent but undercapitalized thrifts and Exhibit VI presents financial highlights and historical financial statements. A solvent but undercapitalized thrift is defined as one that has GAAP capital in excess of 1.5% but less than 6% and positive tangible capital.

Exhibit VII shows the geographical dispersion of the solvent but marginally viable thrifts and Exhibit VIII presents financial highlights and historical financial statements. A solvent but marginally viable thrift is defined as one that has GAAP capital greater than 0% but less than 1.5% and positive tangible capital.

Exhibit IX shows the geographical dispersion of the insolvent thrifts and Exhibit X presents financial highlights and historical financial statements. However, case resolutions accomplished by the FSLIC during the last quarter of 1988 are excluded from this listing. An insolvent thrift is defined as one that has GAAP capital equal to or less than 0% or has negative tangible capital.

IMPACT OF THE ADMINISTRATION'S PLAN ON THE THRIFT INDUSTRY

In the current environment in which the thrift industry operates, it is difficult to assess its overall viability or to analyze the impact of the Administration's plan on the industry.

The large number of insolvent institutions has had a substantial adverse impact on the operations of solvent thrifts as well as commercial banks. The insolvent thrifts have driven up the cost of funds and driven down investment yields. This situation has been exacerbated by the extensive publicity given to the industry by the print and broadcast media.

In spite of the uncertainty of the current industry environment, it is possible to speculate on the impact of the plan on the various classifications of thrifts presented in the preceding table. I anticipate that a result of the implementation of the Administration's plan will be higher investment yields, lower costs of funds, and higher levels of non-interest income. Hopefully, these trends will offset the higher levels of deposit insurance premiums proposed in the plan.

Solvent and Well-Capitalized Thrifts

For the 1,202 thrifts classified as solvent and well-capitalized, the plan will not jeopardize their continued existence. As Exhibit IV demonstrates, these thrifts have an estimated capital to total assets ratio of 8.78% at September 30, 1988, a tangible capital ratio of 7.53% and have adjusted net income of 71 basis points for the nine months ended September 30, 1988. While the income of this group has been declining since 1986, I believe that this group can survive and prosper under the

Administration's plan. However, the total assets of this group constitute only $268 billion or approximately 21% of total thrift assets at September 30, 1988. The 10-year amortization of intangible assets provided by the Administration's plan will have a negative impact on future earnings performance because under GAAP these assets may be amortized over much longer periods.

Solvent But Undercapitalized Thrifts

For the 1,125 thrifts classified as solvent but undercapitalized, the Administration's plan constitutes a considerable and probably unreasonable threat to their continued existence. Moreover, the total assets of this group constitute over $665 billion, or approximately 51% of total thrift industry assets. As Exhibit VI demonstrates, these thrifts have an estimated GAAP capital to total assets ratio of 4.20% at September 30, 1988 and a tangible capital to total assets of 2.96%.

To bring these institutions to a GAAP capital level of 6% of total assets would require additional capital of approximately $12 billion, and to bring them to a tangible capital level of 6% would require approximately $20 billion. In my opinion, neither capital level is remotely attainable by June 1991. These thrifts are not performing at a level of return on equity which will enable them to raise such substantial sums of capital in such a short period of time. The 10-year phase-out of intangible assets would put an additional strain on the income statements of these thrifts by requiring them to write off approximately $500 million more per year than currently required.

These thrifts, many of which are currently in compliance with FHLBB capital requirements, have made business decisions and judgments based upon capital-adequacy criteria which are being drastically changed. Indeed, many investors have made investments in thrifts that will be in "regulatory jeopardy" because of radically and abruptly revised capital rules. Moreover, some institutions in this group are capital-deficient today because they were encouraged by regulators and the investment banking community to engage in portfolio restructuring which substantially reduced their levels of capital, ostensibly to increase future earnings. Finally, there are institutions in this group who were asked by the regulators to serve as unofficial "phoenixes", to accept troubled or insolvent institutions with little, if any, assistance and with the assurance of forgiveness on future capital requirements. Many of these institutions have been described as "regulatory cripples."

In order to raise adequate capital, over 1,000 institutions will have to go to the capital markets or be merged out of existence. I doubt that the financial markets can recapitalize the deserving institutions in that short a period of time. Many viable, healthy, well-managed, and profitable institutions may be "crowded out" of the equity markets because of the large number of offerings, which would have to be completed by June 1991.

Other factors being equal, fairness would seem to dictate that many institutions in this category merit some special consideration in terms of additional time to reach required capital levels. Many of these institutions were victims of an interest-rate cycle in the late seventies and early eighties that stripped them of capital or are "double victims" of a regional real estate depression that wrought havoc upon their loan portfolios. In addition, the industry has suffered from a seriously flawed system of supervision and regulation in which Administrations' policies had, to a large degree, prevented the required bolstering of the supervisory and regulatory system.

Moreover, when "broke" thrift and conservatorship stories are gone from the front pages and business sections of the media, the viable and profitable segment of the industry, which is substantial, will find it much easier to attract investors and raise necessary capital.

Therefore, I would support a selective program of capital forbearances to permit institutions with substantial capital, good earnings prospects, and a clean examination history additional time to raise capital. Such a program should be focused on undercapitalized solvent institutions which have a high probability of success in attracting additional capital. I cannot see that there is any significant risk to the deposit insurance system or the safety and soundness of the financial system in permitting these selective variances from required capital.

In short, I would strongly recommend cleaning up the insolvents quickly, reforming the regulatory structure, recapitalizing the insurance funds, removing the perception of "taint" from the industry, and letting these institutions manage their way into increased profitability and capital compliance.

Solvent But Marginally Viable Thrifts

For the thrifts classified as solvent but marginally viable, Exhibit VIII demonstrates that these thrifts are, in the aggregate, losing money and are unlikely either to recover on their own or be able to attract the levels of capital necessary. I believe that thrifts in this category will, for the most part, be merged or liquidated.

Insolvent Thrifts

I expect most of the thrifts in this category to be merged or liquidated and this is clearly where most of the resources provided by the Administration's plan will be expended. However, there are a small number of thrifts included in this category that have negative tangible capital due to purchased servicing, rather than goodwill. The FHLBB does not release a breakdown of the components of intangible assets by institution, so it is not possible to determine the number of thrifts affected. However, both the FDIC and the proposed capital regulations of the FHLBB treat purchased servicing differently from goodwill.

SUFFICIENCY OF FUNDING TO RESOLVE THE PROBLEM

The Administration's plan provides for $90 billion, exclusive of financing costs, in funding to satisfy prior FSLIC commitments and resolve current problems in the FSLIC's case load. Assuming that $40 billion is adequate to satisfy prior commitments of the FSLIC, I believe that $50 billion is a reasonable estimate of the cost to resolve all thrifts which are now GAAP insolvent or will become so over the next three years, assuming no severe economic or interest-rate cycles. While the cost of case resolution will continue to be very high in areas where asset values are severely depressed, such costs should be much lower in areas of the country where asset values are stable or improving.

In the final analysis, the total cost of case resolution for the thrift industry is just as much a "moving target" today as it has been in the past. The ultimate cost is dependent on the health of the national economy, future interest rates, the revitalization of regional real estate economies, and the regulatory approach to case resolution.

The Administration has projected a growth rate of 7.2% in insured deposits during the next several years. This growth rate appears very optimistic. In fact, I would anticipate that the growth rate for insured deposits will be almost flat for the foreseeable future. The requirement to increase capital levels for that portion of the industry holding approximately 60% of industry assets will, in all likelihood, put pressure on most thrifts to shrink their deposit base. Finally, the interest-rate assumptions for required borrowing to fund this program may be unrealistically low.

In addition to the questions contained in your letter, Mr. Chairman, there are four other issues that I would like to address briefly:

IS A SEPARATE THRIFT INDUSTRY NEEDED?

The federal savings and loan system with deposit insurance was created and developed as an instrument of national housing policy. This system of housing finance has served the nation and its citizens well. It has been an extremely effective mechanism for implementing our goals of home ownership and decent and safe shelter for the American public.

If housing is to continue to be a social priority and we wish to maintain our high levels of housing standards, I would be reluctant to extinguish the industry largely responsible for those successes in the belief that other parts of the financial system would adequately fill this void. In short, I would be skeptical about a national policy which would rely on Wall Street to meet our national housing needs.

I believe that competition and a diversity of housing finance systems has and will serve our nation well. To achieve that goal simply requires that we both encourage and maintain a soundly capitalized and adequately supervised and regulated savings and loan system.

IS THE THRIFT INDUSTRY VIABLE?

Is a savings and loan industry with diminished asset powers and more closely tied to housing a financially viable industry in the future?

If variable-rate mortgages had been widely authorized and available twenty years ago, I doubt that we would be facing the present crisis. Savings institutions would have been much better matched in terms of asset and liability duration and would not have suffered the earnings and capital losses that occurred in the late 1970's and early 1980's. Many institutions got into trouble because of other real estate financing, not housing finance. Tax considerations created a boom in the building of commercial real estate structures of all sorts--many of which had no fundamental economic rationale--but the "numbers" worked, on paper. Better appraisals and effective underwriting, which will result from more effective supervision and regulation, should substantially lessen the risk of this financing activity to the insurance funds. Perhaps there should be some tightening of investment powers or percentages of portfolios that can be invested in non-housing finance. However, I am leery of forcing the industry to become too specialized in single-family mortgages.

The evidence seems clear that savings institutions which have capital, are well-managed, and are not prisoners of a regional depression have performed well over the last 10 years in spite of poor regulation and supervision. Moreover, I see no evidence that the mortgage finance business is inherently unprofitable. Intense competition (teaser rates, etc.) has temporarily driven down mortgage yields and bad publicity about the thrift industry has driven up the costs of funds.

Accelerated case resolutions of insolvent institutions will reduce the costs of funds, and better management of the pricing of mortgage products will restore most of the solvent industry to higher levels of profitability. Adequate risk-based capital requirements coupled with sound supervision and regulation with enhanced powers for the insurance funds (perhaps including ability to vary insurance premiums) should protect the public interest without hamstringing viable savings institutions.

IS THE CONSERVATORSHIP PROGRAM DESIRABLE?

The FDIC has announced that it intends to place several hundred thrifts into conservatorship over the next few weeks or months. I have some concerns about this policy.

Conservatorship is not a solution to the problems of a troubled institution. At best, it is merely a means of "warehousing" problem institutions until the FDIC can organize its staff and financial resources to deal with insolvent institutions. Moreover, it appears that the "conservatorship policy" announced by the FDIC is draining funds out of many institutions, particularly those "announced in the press" each week as insolvent, and may be driving up the cost of funds for solvent institutions.

In the absence of an established and effective case resolution process by the FDIC, merely appointing more conservators may worsen rather than ameliorate the situation. Until case resolutions by the FDIC do proceed, conservatorships should be limited to those institutions that, because of their current management and unsound management policies, pose an immediate and growing threat to the safety and soundness of the financial system or the liability of the insurance fund.

HOW SHOULD THE REGULATORY STRUCTURE BE CHANGED?

Should the regulator for the savings and loan industry be "independent" or part of the incumbent administration?

In my view there should be a very substantial, healthy, and vigorous surviving thrift industry with a housing finance mandate. Accordingly, it would make sense to continue a separate regulatory system for savings institutions rather than turning these responsibilities over to bank regulators, with the following caveats:

- The authority of the insurance funds (as the Bush plan proposes) must be strengthened vis-a-vis the regulators;
- The insurance agency should be independent of the savings institution regulator; and

- There should be a better mechanism to assure closer coordination and cooperation between the various financial institutions regulators and the insurance funds.

The Bush Administration proposal does expand the FDIC Board, but perhaps the Federal Financial Institutions Examination Council should be reinvigorated and given a broader mandate in order to meet these objectives.

The benefits of having the Chairman of the FHLBS report to the Secretary of Treasury are not clear. The Bank Board was created as an independent regulatory agency for the same reasons that the Federal Reserve System was--to insulate the agency from short-term political pressures of the Administration. In reality, the Bank Board and the FSLIC often have not acted as an independent regulatory insurance agency but as a "captive" of the incumbent administration. There has been "political control" of agency budget, staffing levels, and personnel compensation levels. The results have been disastrous. In spite of the warnings of past Bank Board Chairmen, essential staff needs of the agency have been ignored by past Administrations. Competitive salaries have not been available to attract sufficient numbers of competent personnel. And today, the improved compensation systems of the regional bank staff are under attack by the General Accounting Office.

In short, it has been the lack of real independence of the Bank Board from the politics and policies of the Administration that has contributed to the crisis we face today. Merely transferring regulatory responsibilities to the Treasury Department and the FDIC does not meet the "never again" test.

The Federal Reserve model, which ensures more independence and insulation from Administration policies, may well be a preferable system for "bank" regulators and insurers.

CONCLUSION

To summarize my views:

- The nation would be well served by maintaining the present housing finance system. Savings institutions have an important role to play in achieving our housing objectives.

- o A "housing specialized" depository institution providing long-term financing is not inherently unstable and unprofitable. Once the surviving industry is recapitalized, it should be both viable and profitable.
- o Complete compliance with the new capital requirements by June of 1991 is unattainable for many viable and profitable institutions, and such an early deadline would be an undesirable and counterproductive policy.
- o The proposed reorganization of the savings institution regulatory structure is not well thought out. It does not provide "independence" for the regulators nor protect against future political interference in the decisions and operations of the regulators and insurance agency.
- o The estimated costs of case resolution seem reasonable.
- o The revenue projections for the insurance agency and the assumptions underlying the anticipated costs of financing the assistance are unduly optimistic.
- o Speedy and vigorous case resolutions are essential to protect the financial health of the 2,000 or more potentially viable and profitable savings and loan institutions.

The CHAIRMAN. I want to thank you for appearing today and for the work that you have done in your formal presentation, which of course we are making a part of the record. But it is very important that we have independent viewpoints from persons who are in a position to give an arm's-length assessment who we feel have the standing to do so. I appreciate the amount of work that is required, but I want just to thank you for appearing.

Mr. Treadway, maybe I will have you start by giving a sketch of your professional background before getting into your summary of your testimony.

STATEMENT OF PETER TREADWAY, VICE PRESIDENT, SMITH BARNEY

Mr. TREADWAY. Thank you.

I am the savings-and-loan stock analyst at Smith Barney. I earn my livelihood by advising investors on which savings and loan stocks are most likely to go up, an undertaking which some may term "Mission Impossible," in view of the current crisis. I am an economist by background, and in 1976–81, I was the chief economist at FNMA here in Washington.

The administration's FSLIC funding plan, as I see it, conceptually is a good one because it does not allocate the full costs of the savings and loan industry and places heavy emphasis on thrifts meeting appropriate capital guidelines.

I think the details of the plan leave a great deal to be desired and, particularly in respect to the Federal Home Loan Banks, are confiscatory and unfair.

Any plan to clean up the current FSLIC mess should not create incentives to force capital out of the industry in home mortgage lending. This means that efficiently run, well-capitalized savings and loans must be able, by originating and holding mortgages, to earn a risk-adjusted rate of return on their shareholders 'equity that is competitive with other industries. Today, capital goes where the returns are highest, anywhere in the world.

To succeed, any plan to clean up the FSLIC mess and prevent a new crisis in the future must attract equity capital to the efficient, well-run thrifts and not chase capital away by confiscating the assets of the efficient institutions.

Nor must the expected rate of return on home mortgage lending by Government policy be held so low as to force thrift managers of publicly held companies to avoid this activity and to seek lending opportunities in other higher-risk activities.

Now, I would just briefly say I agree entirely with what was said before, that the effect on the capital markets of the borrowed $90 billion plus is zero to perhaps positive. The money has already been spent.

The insolvent thrifts can be thought of as Government corporations which have already lost the money. Without deposit insurance, the deposit runs would have shut these institutions down long ago before they had ever become so insolvent.

So, what I heard this morning I totally agree with, that the borrowing and the spending—whatever it is, $90 billion or more—is not spending in an economic sense. The money has already been spent.

I would turn to the REFCORP, which is in my opinion not the most efficient way to raise funds. Research done by Smith Barney's fixed-income research department suggests that the Treasury's assumption that REFCORP borrowing would cost 30 basis points more than straight Treasury borrowing is reasonable.

But in my opinion, it is not the best way to finance the resolution. The only beneficiaries of REFCORP are the investors who reap windfall gain by accepting lower liquidity of a smaller issue and marginally lower credit quality.

In my opinion, REFCORP will add about $150 million a year in extra financing costs as opposed to straight Treasury borrowing. The Treasury borrowing directly clearly is the most efficient way to go. And I think that was also obvious from the testimony this morning.

Now, on the positive side, the administration's plan to liquidate insolvent and near-insolvent thrifts by enforcing capital regulations similar to those for banks, will curtail the overcapacity in the industry and ultimately improve the risk-adjusted rate of return of the remaining thrifts.

I think that within 5 years, two-thirds to four-fifths of the 3,000 or so FSLIC savings and loans today will have been liquidated, merged, or voluntarily closed down.

I believe that this reduction of overcapacity is an essential ingredient in avoiding another crisis down the road. And I strongly would support rigorous enforcement of capital regulations. I think that thrifts that cannot meet the capital requirements should be forced to raise additional capital, should be forced to merge or to shrink down.

I think leniency in the capital respect will simply create a new group of insolvent companies that will go out of their way to engage in risky activities which in the majority of cases will push them under.

I want to turn now to the impact on the thrift industry, what I call the confiscatory side, and start out by saying I think the administration's assumption that the savings and loan deposits will grow at 7.2 percent a year is conceptually flawed.

This whole program will shrink the industry for at least the next 5 years, the next 3 to 5 years. As the overcapacity in the industry is removed, the deposit base will shrink. I believe the deposit growth for the next couple of years will be negative until we at least shrink the overcapacity. Then, if the industry is still a profitable sector of the economy, the deposits will grow.

So, the assumption about 7.2 percent, at least in the in-close year, is simply not feasible. And logically, if the plan succeeds, 7.2 percent cannot be the number. It is a contradiction.

I want to turn to the Home Loan Banks. The administration's funding plan calls for the use of the Federal Home Loan Banks in a manner which is unfair and, I think, totally disregards the problem of property rights of their thrift owners.

A total of $11.7 billion will be contributed by Federal Home Loan Banks in a series of payment for the next 30 years. I think this contribution will significantly reduce, if not eliminate, the borrowing abilities of the Home Loan Banks for the thrifts as well as the dividends that they receive on their stock, which is an important asset in the thrift industry.

It is interesting that constantly people have expressed the need for a separate housing finance sector and for a separate thrift industry. But I think parts of the administration's funding plan seem to need a separate thrift industry so as to cordon off the healthy thrifts so as to more easily confiscate their net worth.

The committee should realize, in my opinion, that the Federal Home Loan Banks are an important Federal subsidy to the home mortgage sector and that it gives thrifts a borrowing window to the agency sector of the market.

Were it to be concluded that housing no longer needs this subsidy, the course of action would be—which would be fairer and consistent, in my opinion—to simply liquidate the Home Loan Banks and pay off the thrifts' shareholders.

I think also the use of the Home Loan Banks as an emergency source of credit to insolvent thrifts experiencing outflows is a questionable procedure. The Home Loan Banks did not have the power to create money like the Federal Reserve and, consequently, are not a central bank for thrifts. They must borrow from the capital markets based on their balance sheet and income statement strength and with only the applied moral guarantee from the U.S. Government.

If the Home Loan Banks are forced to make loans based on dubious collateral with serious probability of nonrepayment, the capital markets would downgrade their credit standing. Confiscating the net worths of the Home Loan Banks and forcing them to make substandard loans runs the risk of creating another bankrupt agency borrower.

Finally, I would like to turn to two other topics.

Deposit premiums. The administration plan assumes still an inequality of deposit premiums paid by thrifts versus banks, though the inequality is reduced. It is hard for me to understand why the two groups of financial institutions should pay two separate premiums, the thrifts of course paying higher ones.

And I should note that the two largest thrifts in the country and two very efficient companies, Great Western and H.F. Ahmanson, have both applied to leave the FSLIC.

And for capital to leave the industry and in terms of the 7.2 percent, it makes it even harder to reach.

Finally, I would just add to the other witnesses comment that the assumptions on interest rates are just optimistic.

Heaping these confiscatory types of taxes, both directly through the deposit fees as well as in the Home Loan Banks, will create incentives for capital to leave the industry and in terms of the 7.2 percent it makes it even harder to reach.

Finally, I would add to the other witnesses that the assumptions on interest rates are just optimistic, and we can speculate just what interest rates will be. What we need is $35 barrel oil and 5 percent home mortgage rates in order to really help the industry, and that is a dream assumption!

I think the fact has to be faced, as it was faced here this morning, that the Treasury has an open end commitment on this and that the money, in a sense, has already been spent and we need to move as rapidly as possible to stop the further hemorrhaging and further losses.

Thank you.

[The complete prepared statement of Peter Treadway follows:]

SMITH BARNEY

Testimony Before The Senate Committee on Banking, Housing and Urban Affairs

March 3, 1989

Peter Treadway, Vice President, Smith Barney

SUMMARY
Peter Treadway

The Administration's FSLIC funding plan conceptually is a good one because it does not allocate the full cost to the savings and loan industry, and places heavy emphasis on thrifts meeting appropriate capital guidelines. But the "details" of the plan leave a great deal to be desired and are, particularly in respect to the Federal Home Loan Banks, confiscatory and unfair.

Any plan to clean-up the current FSLIC mess should not create incentives to force capital out of the industry and home mortgage lending. This means that efficiently run, well capitalized savings and loan institutions must be able by originating and holding mortgages to earn a risk-adjusted return on their shareholders' equity that is competitive with other industries. Today, capital will go where returns are highest, anywhere in the world.

To succeed, any plan to clean-up the FSLIC mess and prevent a new crisis in the future must attract equity capital to the efficient, well run thrift instututions and not chase capital away by confiscating the assets of the efficient institutions. Nor must the expected rate of return on home mortgage lending by government policy be held so low as to force thrift managers of publicly held companies to avoid this activity and seek lending opportunities in other higher risk activities.

EFFECT OF THE PROPOSAL ON CAPITAL MARKETS - ZERO TO POSITIVE

The Administration's plan does not drive up the overall level of interest rates because the $90 billion needed to resolve the crisis in an economic sense has already been spent. The insolvent thrifts never would have been allowed by a free market to run up a total insolvency of $90 billion plus without FSLIC guarantees, which are de facto government guarantees. Deposit runs would have shut these institutions down, long before they ever became so insolvent. In an economic sense, the insolvent thrifts are money losing federal government corporations, which would have long ago been closed by a free market. The federal government in reality has already borrowed this $90 billion plus off-budget by allowing the insolvent thrifts do the borrowing with its guarantee. Any borrowings now by the Treasury/Refcorp/FICO, simply refinance the deposits and borrowings of liquidated thrifts.

REFCORP IS NOT THE MOST EFFICIENT WAY TO RAISE FUNDS

Research done by Smith Barney's Fixed Income Research Department suggest that the Treasury's assumption that Refcorp borrowing will cost 30 basis points more than straight Treasury borrowing is reasonable.

But Refcorp is not the best way to finance a resolution. The only beneficiaries of Refcorp are investors who reap a windfall gain by accepting lower liquidity of a smaller issue and marginally lower credit quality. Refcorp will add $150 million per year in extra financing costs as opposed to straight Treasury borrowing.

The thrifts and the Federal Home Loan Banks (if they are to contribute) could simply make their contributions directly to the Treasury.

IMPACT ON THE THRIFT INDUSTRY - THE POSITIVE SIDE

The Administration's plan, by promising to liquidate insolvent and near insolvent thrifts and by enforcing capital regulations similar to those as for banks, will curtail the overcapacity in the industry, ultimately improve the risk adjusted rates of return of the remaining healthy, efficient thrifts, and substitute sound levels of capital for the undisciplined use of federal deposit guarantees. My estimate would be that within five years 2/3 to 4/5 of the 3,000 or so FSLIC savings and loans operating today will have been liquidated, merged or voluntarily closed down. Frankly, this reduction of overcapacity is an essential ingredient in avoiding another crisis down the road and is crucial for attracting capital to the healthy sector of the industry.

Only most efficient, best capitalized and probably the largest savings and loans are going to survive. Whether these larger, more efficient companies themselves can survive as independent companies and not be bought by banks will depend on how successful they are in attracting new capital and raising their currently depressed share prices. In part this will be a function of whether the confiscatory aspects of the Administration's funding program are removed.

IMPACT ON THE THRIFT INDUSTRY — THE CONFISCATORY SIDE

The Administration's assumption that savings and loan deposits will grow at 7.2% per share is conceptually flawed. As overcapacity is removed, deposits for the industry as a whole will shrink. Moreover, the confiscatory side of the plan further ensures that this assumption is unreasonable since it may discourage capital and deposits in savings and loans. In the past, a separate thrift industry was deemed necessary as a subsidy for housing. Parts of the Administration's funding plan seems to need a separate thrift industry so as to cordon off the healthy thrifts so as to more easily confiscate their net worth.

Degradation of the Federal Home Loan Banks

The Administration's FSLIC funding plan calls for a use of the Federal Home Loan Banks in a manner which is unfair and totally disregards the property rights of their thrift owners. A total of $11.7 billion will be contributed by the Federal Home Loan Banks in a series of payments over 1989-2019.

This contribution will cause dividends from the Federal Home Loan Banks to their thrift owners to be reduced significantly — if not eliminated — as well as reducing the borrowing ability of the FHLBs. Even of the plan does not need to invade FHLBs' paid-in capital and hence cause a dollar for dollar write down of thrift holdings, the stock market will likely reduce the value of publicly traded thrifts by the present value of the hit to their holdings of FHLB stock.

The Committee should realize that the Federal Home Loan Banks are an important federal "subsidy" to the home mortgage sector in that it gives thrifts a borrowing window to the agency sector of the credit market. Were it to be concluded that housing no longer needs this special subsidy, the course of action which would be fair and consistent with the U.S. respect for property rights would be simply to liquidate the FHLBs and

payoff their thrift owners. Confiscation of FHLBs' net worth without compensation is something the Administration would be quick to condemn were it to be done by a foreign government to American assets in a foreign country.

A more honest alternative would be to raise deposit premiums to levels which were deemed necessary. At least the premium increases would be a tax deductible expense.

The Committee should also be aware that this proposed degradation of the FHLBs will particularly punish smaller institutions. While a few large profitable institutions can access the capital markets as borrowers and have obtained ratings from the rating agencies, smaller profitable associations cannot. Consolidation of the industry is inevitable but degradation of the FHLBs will make it occur faster.

Also, the use of the FHLBs as an emergency source of credit to insolvent thrifts experiencing outflows is a questionable procedure. The FHLBs do not have the power to create money like the Federal Reserve and condequently are not a central bank for thrifts. They must borrow from the capital markets based on their balance sheet and income statement strength and with perhaps the implied moral guarantee but not full faith and credit of the U.S. government. If the FHLBs are forced to make loans based on dubious collateral and with a serious probability of non-repayment, the capital markets will downgrade their credit standing. By confiscating the net worth of the FHLBs, and forcing them to make substandard loans, does not the Administration plan run the risk of creating a bankrupt agency borrower?

Deposit Premiums — The Inequality Persists

The healthy thrifts are no more responsible for this crisis than the banks. The issue of what is the proper level of premiums is another subject but there is no reason why thrifts should pay more than banks.

The higher proposed levels FSLIC premiums as compared with FDIC premiums is an obvious disincentive to attracting new capital into the industry, and could even result in lower overall premium income from FSLIC companies. It is a very ominous sign the fact that the nation's two largest and, definitely healthy thrifts, i.e. **Great Western and H. F. Ahmanson**, have now made application to leave the FSLIC. The higher FSLIC premium makes the 7.2 % percent deposit growth assumption even more unrealistic.

SUFFICIENT FUNDING FOR THE PLAN

By now, yet another estimate of the FSLIC clean-up would serve little purpose. $90 billion would seem to be a minimum number.

What is becomming clear is that the Treasury's commitment on this is really open ended. But since in an economic sense the money has already been spent there is no fear on the interest rate front. Moving as fast as possible to liquidate insolvent institutions keeps the real loss from growing larger.

By way of introduction to the Committee, I am the savings and loan stock analyst at Smith Barney. I earn my livelihood by advising investors on which savings and loan stocks are most likely to go up, an undertaking that some may term "mission impossible" in view of the current crisis. I am an economist by background and, in 1976-81, was employed at the Federal National Mortgage Association, for the bulk of that time as Chief Economist.

Let me say at the outset that any plan to clean-up the current FSLIC mess should not create incentives to force capital out of the industry and home mortgage lending. This means that efficiently run, well capitalized savings and loan institutions, must be able by originating and holding mortgages to make a risk-adjusted return on their shareholders' equity that is competitive with other industries. Today, capital will go where returns are highest, anywhere in the world.

To succeed, any plan to clean-up the FSLIC mess and prevent a new crisis in the future must attract equity capital to the efficient, well run thrift institutions and not chase capital away by confiscating the assets of the efficient institutions. Nor must the expected rate of return on home mortgage lending by government policy be held so low as to force thrift managers of publicly held companies to avoid this activity and seek lending opportunities in other higher risk activities.

The Administration's FSLIC funding plan conceptually is a good one because it does not allocate the full cost to the savings and loan industry, and places heavy emphasis on thrifts meeting appropriate capital guidelines. But the "details" of the plan leave a great deal to be desired and are, particularly in respect to the Federal Home Loan Banks, confiscatory and unfair.

EFFECT OF THE PROPOSAL ON CAPITAL MARKETS

1. Zero to Positive As Far As The Overall Level of Interest Rates Goes

Whatever the final number is — call it $90 billion plus for the sake of discussion -- from a macroeconomic point of view the impact of the Administration's plan on the overall level of interest rates is zero to positive. The Administration's plan does not drive up the overall level of interest rates. The reality is that the money has already been spent in an economic sense and the interest rate effect, whatever it is has already been felt. The $90 billion in Refcorp/Treasury/FICO borrowings simply replace $90 billion in deposits and borrowings of the liquidated thrifts.

The insolvent thrifts never would have been allowed by a free market to run up a total insolvency of $90 billion plus without FSLIC guarantees, which are de facto government guarantees. Deposit runs would have shut these institutions down, long before they ever became so insolvent. In an economic sense, the insolvent thrifts are money losing federal government corporations, which would have long ago been closed by a free market. The federal government in reality has already borrowed this $90 billion plus off-budget by allowing the insolvent thrifts to do the borrowing with its guarantee. One could argue that the total thrift insolvency figures should have been added to the government deficit as the losses were incurred.

There is no new spending going on here, except of course on the lawyers, accountants, investment bankers etc involved in the transactions. Therefore, there is no new demand on resources and hence no potential for raising the overall level of interest rates. Whether or not the federal government deficit is increased by all of this is irrelevant as far as the overall level of interest rates goes.

In fact, longer run one could argue that liquidating the insolvent thrifts will push interest rates down. Estimates are that insolvent thrifts continue to lose roughly one billion dollars per month. These on-going losses are real resources wasted on clearly unproductive uses which could be better employed elsewhere.

I would argue that doing nothing because of worries about what is an accounting convention i.e., the reported federal government deficit, will raise the overall level of interest rates. This would allow insolvent thrifts to continue to lose money, which in an economic though not an accounting sense, does constitute government spending.

2. Refcorp Is Not The Most Efficient Way to Raise Funds

The Administration's proposal envisions a separate government corporation called the Resolution Funding Corporation (Refcorp) which would borrow $50 billion. The Administration assumes, as I understand it, that Refcorp would borrow at about 30 basis points above regular Treasury borrowings. The Treasury would be obligated to pay the shortfall from contributions from the Federal Home Loan Banks and the savings and loan insurance premiums.

Research done by Smith Barney's Fixed Income Research Department, is that on average Refcorp borrowings will cost roughly 25-35 basis points more than straight Treasury borrowings. In this case, the Treasury assumption is reasonably conservative. Smith Barney based its analysis on two considerations:

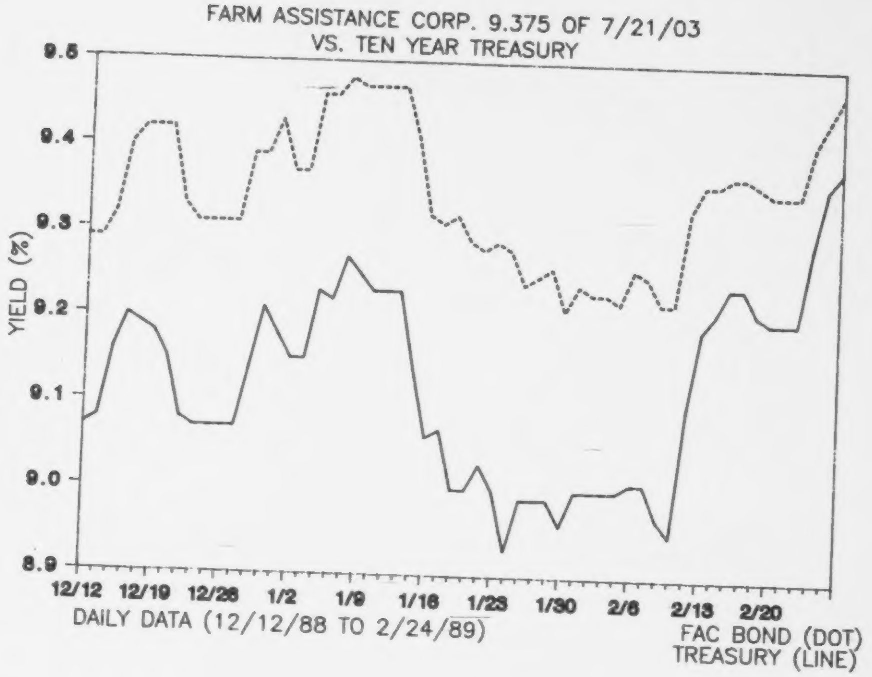
1. The Refcorp borrowings as separate issue would be less liquid than larger and more regular Treasury offerings.

2. There is still some slight implication of lower credit quality as compared with straight Treasury debt.

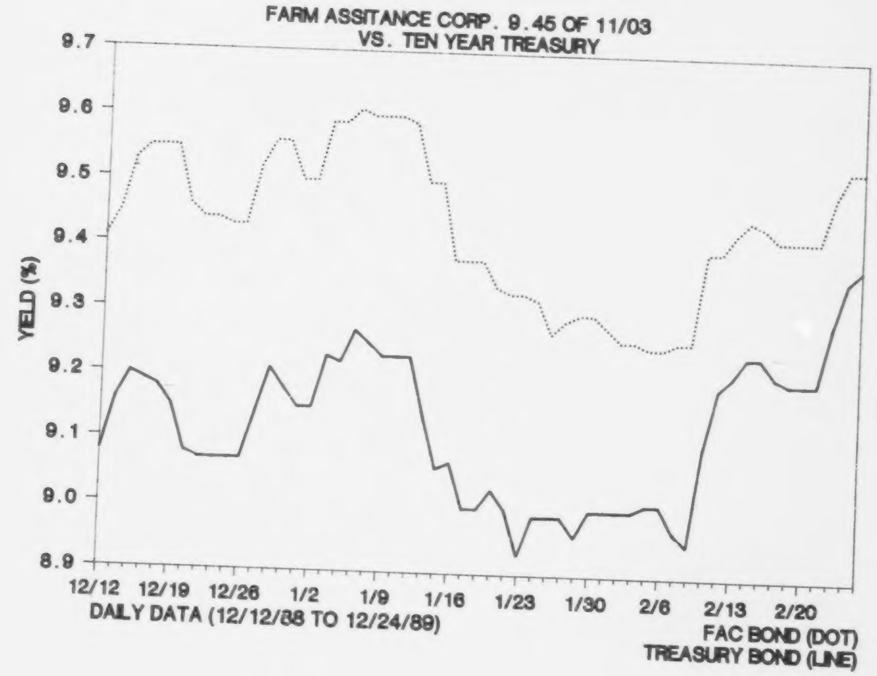
Charts 1-3 show that similar off-Treasury borrowings, including those for FICO and the Farm Assistance Corp, all sell at various spreads above the Treasury curve.

Assuming the Treasury estimate is reasonably accurate, this implies that a financing vehicle is being set up which will incur financing costs each year which are $150 million greater that straight Treasury borrowing. Given that the $90 billion plus is already "spent money", straight Treasury financing makes a great deal of sense.

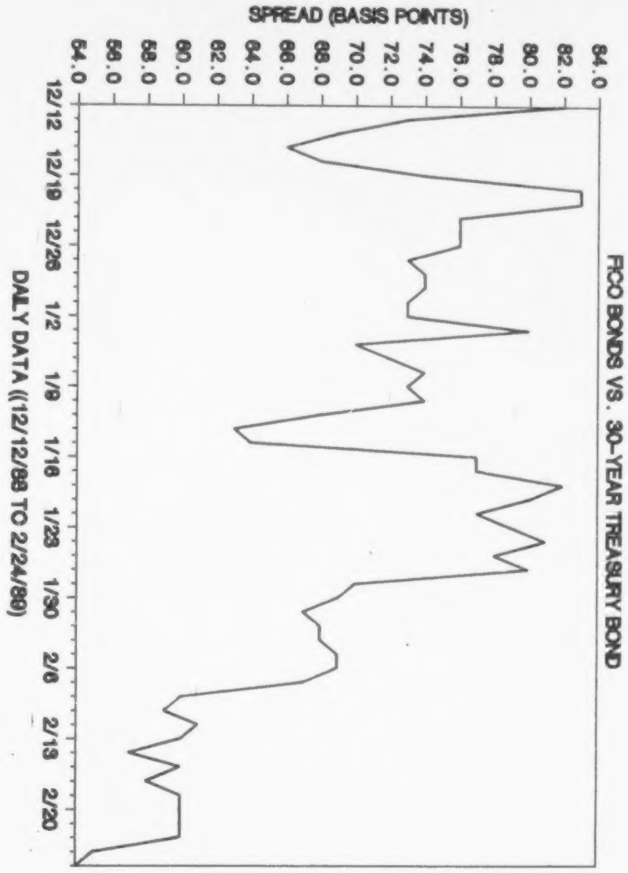
Refcorp is not the best way to finance a resolution. The only beneficiaries of Refcorp are investors who reap a windfall gain by accepting lower liquidity of a smaller issue and marginally lower credit quality.



FARM ASSISTANCE CORP. 9.375 OF 7/21/03
VS. TEN YEAR TREASURY



FARM ASSITANCE CORP. 9.45 OF 11/03
VS. TEN YEAR TREASURY



Treasury debt is the cheapest way to go. The thrifts and the Federal Home Loan Banks (if they are to contribute) could simply make their contributions directly to the Treasury. The resulting Federal deficit increases would only be an accounting -- not a real or economic -- problem and there would be no effect on inflation or the overall level of interest rates.

IMPACT ON THE THRIFT INDUSTRY

Some Basic Industry Economics As Seen By Investors

Before answering the question regarding the effect of the funding plan on the thrift industry, I think it is important to understand how investors look at the industry. If more private capital is going to be raised and mortgage originating and lending is to be regarded as an attractive business, the thrift industry must offer a competitive rate of return on a risk adjusted basis as compared with other industries. The following points need to be made:

1. Up until now at least, even healthy thrifts on average have not been able to offer a competitive risk adjusted return which was attractive to investors. The proof of this is easy to find:

a. Publicly traded stock thrifts sell at a discount to book value, and earn mediocre rates of return especially when adjusted for capital gains, non-recurring items and interest rates risk. For example, the nine largest and best run publicly traded thrifts in California, whose assets are primarily home mortgages, managed to earn 10.4% on equity in 1988 after adjusting for non-recurring items. (See Table 1) All publicly traded thrifts probably earned half that. At the same time, the sample of the best large thrifts sold at 70% on average of their book value. Lesser thrifts sell at greater discounts.

What this means is that virtually none of the thrifts in the United States, with the possible exception of two efficiently run large California thrifts which sell above book value, could go to the equity market today and raise equity capital without diluting their existing shareholders. To put this another way, $1 invested in a thrift at its book value today immediately gets valued at less than $.75 by the equity market. Who needs to invest in thrifts and get a rate of return of 5%-10% when one can buy a CD from the same thrift that currently yields the same thing?

b. In two differing situations, investors have put substantial funds in thrifts as an investment but only when a special sweetener was thrown in. In the first case, Smith Barney estimates that $6.85 billion has been raised in thrift equity since 1983 for stock issues involved with conversions from mutual form. This is an impressive amount. But here investors got a windfall i.e., the book equity that had been accumulated in these companies as mutuals was deeded over gratis to the stock investors in the conversion process. Moreover, many invested with the ultimate hope that their company would quickly be bought out. The second case was the recent, controversial set of

Table 1

Core ROE and Price/Book Value of
Premier California Savings & Loans

Name	Core ROE	Price/Book
H.F. Ahmanson	11.00%	85.70%
California Federal	4.42	40.00
Coast Savings	8.93	43.50
Golden West Financial	16.39	123.50
Glendale Federal	11.94	57.00
Great American	7.94	46.30
Great Western	10.77	99.30
Home Federal SD	12.00	66.80
Average	10.42	70.26

Note 1: Core return on equity calculated by assuming gain on loan sales of 1.5% only.

Note 2: Price to book calculated using prices as of February 24, 1989 and book values as of December 31, 1988 for the appropriate companies.

Source: Smith Barney Savings & Loan Research Group

FSLIC deals done in 1987-88 in which investors were accorded all kinds of extra "goodies" in the way of tax benefits, guarantees from FSLIC etc. Whether or not FSLIC was overly generous, the fact remains that without some special incentives no equity capital would have been forthcoming.

2. In my opinion, the lower risk adjusted rate of return that thrifts have earned is due to relatively low spreads prevailing on home mortgages. In other words, holding home mortgages has not been all that profitable for thrifts or banks for that matter. This is due to three factors:

a. Government-subsidized massive overcapacity in the industry. This has come about because FSLIC has freely handed out its deposit insurance to firms which are insolvent or which are below capital levels dictated by sound banking practice. Freely handed out FSLIC insurance has substituted for capital. No other industry in the United States finds the government effectively guaranteeing the liabilities of failed or near failed firms so they can compete with the industry's healthy firms. The spectacle of insolvent thrifts bidding up deposit costs for all thrifts is the most extreme symptom of the harmful effects of this overcapacity. But marginally capitalized firms are part of the overcapacity problem as well. Firms with more rather than less capital have actually been penalized because, since Uncle Sam is effectively guaranteeing a thrift deposit, capital is unneeded. No wonder investors have needed to be "bribed" to invest in thrifts!

b. The rise of the secondary mortgage market. Favored by improvements in computer, financial and information technology, the secondary market has enabled non-thrift investors to compete successfully with thrifts as holders of home mortgages.

c. The participation in that market of three agency status entities. **Fannie Mae, Ginnie Mae** and **Freddie Mac** have better access to capital and lower capital requirements than thrifts. (assuming thrift capital requirements are enforced)

d. The home mortgage has become a commodity. The information, computer and financial technology revolutions favor large, low cost, and, I believe, nationwide mortgage originators. The national consolidation of the thrift industry is in my opinion inevitable.

3. The Administration's plan, by promising to liquidate insolvent and near insolvent thrifts and by enforcing capital regulations similar to those as for banks, will drastically curtail the overcapacity in the industry, ultimately improve the risk adjusted rates of return of the remaining healthy, efficient thrifts, and substitute sound levels of capital for the undisciplined use of federal deposit guarantees. My estimate would be that within five years 2/3 to 4/5 of the 3,000 or so FSLIC savings and loans operating today will have been liquidated, merged or voluntarily closed down. Frankly, this reduction of overcapacity is an essential ingredient in avoiding another crisis down the road and is crucial for attracting capital to the healthy sector of the industry.

Table 2

Administration Assumptions

New FICO (REFCORP) Financing
($ in billions)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
New FICO (REFCORP)								
Principal covered by zeros paid with private funds:								
FHLB Retained Earnings	0.8	1.1	0.8	0.0	0.0	0.0	2.7	2.7
S&L Insurance Premiums	0.0	1.7	1.7	0.0	0.0	0.0	3.3	3.3
Total Defeasance	0.8	2.8	2.5	0.0	0.0	0.0	6.0	6.0
Interest covered by private a public funds:								
FHLB Future Income	0.0	0.0	0.0	0.3	0.3	0.3	0.9	2.4
Receivership Proceeds	0.0	0.5	1.8	2.6	2.7	2.4	10.0	12.0
Treasury Funds	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
Total Interest	0.5	1.9	3.4	3.8	3.8	3.8	17.2	36.4

4. It may seem contradictory that the thrift industry would simultaneously be characterized by overcapacity and need more capital. But it is not for two reasons. First, the overcapacity is the result of the indiscriminate and reckless substitution of the FSLIC guarantee for capital, a practice which the Administration plan will hopefully eliminate. Second, whole areas of the country, i.e. Texas, have witnessed the total elimination of capital in thrifts (and banks). These areas are markets that have a genuine demand for thrift services and, assuming the days of free handouts of FSLIC guarantees to firms without capital are over, capital will be required to provide these services.

5. The following points follow from the above:

a. By eliminating excess capacity by liquidating insolvent companies and by uniformiy enforcing capital regulations which require sound levels of capital and prohibit interest rate mismatches, regulators will inevitably widen the spread on mortgages, i.e., the difference between thrifts cost of funds and their lending (mortgage) rate. In plain English, other things equal mortgage rates have to go up and deposit rates down. Mortgage rates have been "subsidized" by a FSLIC which encouraged overcapacity in the industry via unsound banking practices which have led to the current disaster. My estimate is, however, that the rise in mortgage rates will be relatively modest (10-30 basis points) and that a greater adjustment downward will come on the deposit side.

b. Only most efficient, best capitalized and probably the largest savings and loans are going to survive.

c. Whether these larger, more efficient companies themselves can survive as independent companies and not be bought by banks will depend on how successful they are in attracting new capital and raising their currently depressed share prices. In part this will be a function of whether the confiscatory aspects of the Administration's funding program are removed.

d. The Administration's assumption that savings and loan deposits will grow at 7.2% per year is conceptually flawed. As overcapacity is removed, deposits for the industry as a whole will shrink.

IMPACT ON THE THRIFT INDUSTRY — THE CONFISCATORY SIDE

Degradation of the Federal Home Loan Banks

The Administration's FSLIC funding plan calls for a use of the Federal Home Loan Banks in a manner which is unfair and totally disregards the property rights of their thrift owners.

Under the assumptions I have seen (tables 2-3), it appears that a total of $11.7 billion will be contributed by the Federal Home Loan Banks in a series of payments over 1989-2019. As Table 2 shows, this involves contributions from FHLB Retained Earnings of $.8 billion, $1.1 billion and $.8 billion over 1989-91 to defease the principal of Refcorp borrowings and $300 million per year from FHLB future income apparently over the thirty year lives of the Refcorp bonds to pay interest on those bonds. By my calculation, the present value of this contribution is actually $4.7 billion in 1989 assuming a 9% discount rate. (see table 4) This compares with consolidated FHLB Retained Earnings of $2.8 billion at 12/31/88 and total capital of $15.5 billion.

This contribution will cause dividends from the Federal Home Loan Banks to their thrift owners to be reduced significantly -- if not eliminated -- as well as reducing the borrowing ability of the FHLBs. To some extent the FHLBs give the thrifts a window to agency-cost longer term capital, which is a competitive offset to Fannie Mae, Freddie Mac and Ginnie Mae.

Even if the plan does not need to invade FHLBs' paid-in capital and hence cause a dollar for dollar write down of thrift holdings, the stock market will likely reduce the value of publicly traded thrifts by the present value of the hit to their holdings of FHLB stock.

In terms of the industry attracting more capital, this is a real disincentive. Will anyone rationally invest in an savings and loan when part of that investment will have to be invested in FHLBs stock and hence be confiscated?

The committee should realize that the Federal Home Loan Banks are an important federal "subsidy" to the home mortgage sector in that it gives thrifts a borrowing window to the agency sector of the credit market. Were it to be concluded that housing no longer needs this special subsidy, the course of action which would be fair and consistent with the U.S. respect for property rights would be simply to liquidate the FHLBs and payoff their thrift owners. Confiscation of FHLBs' net worth without compensation is something the Administration would be quick to condemn were it to be done by a foreign government to American assets in a foreign country.

A more honest alternative would be to raise deposit premiums to levels which were deemed necessary. At least the premium increases would be a tax deductible expense.

The Committee should also be aware that this proposed degradation of the FHLBs will particularly punish smaller savings and loans. While a few large profitable institutions can access the capital markets as borrowers and have obtained ratings from the rating agencies, smaller profitable associations cannot. Consolidation of the industry is inevitable but degradation of the FHLBs will make it occur faster.

Also, the use of the FHLBs as an emergency source of credit to insolvent thrifts experiencing outflows is a questionable procedure. The FHLBs do not have the power to create money like the Federal Reserve and consequently are not a central bank for thrifts. They must borrow from the capital markets based on their balance sheet and income statement strength and with perhaps the implied moral guarantee but not full faith and credit of the U.S. government. If the FHLBs are forced to make loans based on dubious collateral and with a serious probability of non-repayment, the capital markets will downgrade their credit standing.

Query: By confiscating the net worth of the FHLBs, and forcing them to make substandard loans, does not the Administration plan run the risk of creating a bankrupt agency borrower?

Table 3

Administration Assumptions

Assumptions	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94		
FICO (CEBA) Rates	9.8%	8.6%					wtd avg (88-90):	9.5%
REFCORP Rates	9.1%	7.9%	6.5%				wtd avg (89-91):	7.7%
Int Rate on LT Treasuries	8.8%	7.6%	6.2%				wtd avg (89-91):	7.4%
Discount on zeros	8.8%	7.6%	6.2%				wtd avg (89-91):	7.4%
Int Rate on FSLIC Notes	9.5%	7.8%	6.1%	4.9%	4.3%	4.0%		
FSLIC Deposit Base ($ in trillions)	1.0	1.1	1.2	1.2	1.3	1.4		
1989-99 Growth Rate	7.2%							
FDIC Deposit Base ($ in trillions)	2.1	2.3	2.4	2.6	2.8	2.9		
1989-99 Growth Rate	6.9%							

Recovery on receivership assets (new cases):
40 cents on each dollar over the 4 years subsequent to liquidation

Table 4

Present Value - FHLB Refcorp Contributions

Period	Amount	PV 9%	PV 8%	PV 7%	PV 6%
1	$800	$734	$741	$748	$755
2	$1,100	$926	$943	$961	$979
3	$800	$618	$635	$653	$672
4	$300	$213	$221	$229	$238
5	$300	$195	$204	$214	$224
6	$300	$179	$189	$200	$211
7	$300	$164	$175	$187	$200
8	$300	$151	$162	$175	$188
9	$300	$138	$150	$163	$178
10	$300	$127	$139	$153	$168
11	$300	$116	$129	$143	$158
12	$300	$107	$119	$133	$149
13	$300	$98	$110	$124	$141
14	$300	$90	$102	$116	$133
15	$300	$82	$95	$109	$125
16	$300	$76	$88	$102	$118
17	$300	$69	$81	$95	$111
18	$300	$64	$75	$89	$105
19	$300	$58	$70	$83	$99
20	$300	$54	$64	$78	$94
21	$300	$49	$60	$72	$88
22	$300	$45	$55	$68	$83
23	$300	$41	$51	$63	$79
24	$300	$38	$47	$59	$74
25	$300	$35	$44	$55	$70
26	$300	$32	$41	$52	$66
27	$300	$29	$38	$48	$62
28	$300	$27	$35	$45	$59
29	$300	$25	$32	$42	$55
30	$300	$23	$30	$39	$52
31	$300	$21	$28	$37	$49
32	$300	$19	$26	$34	$46
33	$300	$17	$24	$32	$44
AMOUNT	$11,700	$4,657	$5,000	$5,400	$5,873

Source: Smith Barney Savings and Loan Reserch Group

Deposit Premiums — The Inequality Persists

The following schedule is suggested for FSLIC and FDIC institutions:

	FDIC - Pool	FSLIC - Pool
1990	12 BP	20.8 BP
1991	15	23
1992	15	23
1993	15	23
1994 and later	15	18

Obviously, even by 1994 bank and thrift premiums are still uneven. Why? What is the justification for this?

The healthy thrifts are no more responsible for this crisis than the banks. The issue of what is the proper level of premiums is another subject but there is no reason why thrifts should pay more than banks.

The higher FSLIC premiums is an obvious disincentive to attracting new capital into the industry, and could even result in lower overall premium income from FSLIC companies. I regard as a very ominous sign the fact that the nation's two largest and, definitely healthy thrifts, i.e. **Great Western** and **H. F. Ahmanson**, have now made application to leave the FSLIC. The higher FSLIC premium makes the 7.2% percent deposit growth assumption even more unrealistic.

SUFFICIENT FUNDING FOR THE PLAN

In my opinion, by now yet another estimate of the FSLIC clean-up would serve little purpose. Considerable time has already been allocated on this subject by some fairly knowledgeable observers. $90 billion would seem to be a minimum number. Moreover, in my opinion, the Administration's estimates are far too optimistic on the growth of thrift deposits -- I believe they will shrink for the next few years -- and optimistic on the subject of interest rates.

Responsible public officials should acknowledge that:

1. The problem was caused by a massive breakdown of the public sector regulatory structure, poorly executed deregulation and slowness to act on the problem. FSLIC deposit insurance was recklessly handed out and allowed to substitute for capital.

2. The Treasury's commitment on this is really open ended, but since in an economic sense the money has already been spent there is no fear on the interest rate front.

3. Moving as fast as possible to liquidate insolvent institutions keeps the real loss from growing larger.

4. The system should be reformed so that the problem does not happen again. The most essential feature of any new system should be an insistence on sound capital levels in exchange for deposit insurance.

5. Looting and degrading the FHLBs is robbing Peter to pay Paul, increases the size of the total cleanup cost and discourages new capital from entering this industry.

6. In the past, a separate savings and loan industry was deemed necessary so as to provide an element of subsidy to housing. Parts of the Administration plan would seem to require a separate savings and loan industry so as to cordon off healthy thrifts so as to confiscate their wealth more easily.

The CHAIRMAN. Mr. Treadway, when you look at the administration's plan, can you go from your points to saying the adjustments that you think would be the most useful ones to the plan? If you were recommending adjustments to it, can you list in rank order the things that you think might be the most important adjustments to the plan or alterations to the plan?

SUGGESTIONS FOR ADJUSTMENTS TO THE PLAN

Mr. TREADWAY. Well, No. 1, I think the REFCORP idea is a needlessly expensive way to go. Even if it is only 30 basis points, it is $150 million a year on that basis. I think the borrowing should be done by the Treasury directly. That would be cheaper.

Now, I won't address—the committee has already and it is a major problem, the Gramm-Rudman discipline. I understand that, but the reality is this is costing much more money.

No. 2, I think that the assessments, deposit premium assessments on the thrifts and banks should ultimately be the same, especially if it is the committee's belief that there should be a separate savings and loan industry. It is contradictory to say that we should have a separate savings and loan industry that has helped housing and then impose a higher deposit premium on it.

No. 3, I think that simply viewing the Home Loan Banks as a source of funds for this is a mistake. The Home Loan Banks are a very arcane subject for most people. I have personally addressed investors who owned substantial holdings of their bonds who didn't understand—these are institutional investors—didn't understand the relationship with FSLIC and the thrift problem and the Home Loan Banks.

So it is hopeless to explain this to the general public. They are faceless victims, in a sense, but the stock of the Home Loan Banks is owned by the thrifts. The total capital is probably around $12 billion in terms of book capital that is on the books of the thrifts. They get a dividend, and they borrow from the Home Loan Banks.

I think it is a real mistake if you want to encourage capital into the industry to be raiding the Home Loan Banks at the same time, and I realize that that will add to the Treasury's cost.

Third, I would say that if we are going to eventually equalize the deposit premiums, that they shouldn't be cast in stone either. It is possible that they could be raised. I would rather see higher deposit premiums than the Home Loan Banks have their net worth essentially be confiscated.

So I guess those are the major points that I would make. You can change the interest rate assumptions, and you will get bigger numbers.

The CHAIRMAN. Mr. Ferguson, could I ask you to respond to the same question? I know you gave us a summary, but in rank order in terms of the adjustments to the plan that you would feel are most important for us to consider making.

Mr. FERGUSON. Yes, sir, and I don't think they differ very much from Mr. Treadway. I am not an economist, but it would appear to me as a CPA that Treasury borrowings would be the cheapest way to go to resolve this problem. The money is already spent. The loss is already incurred.

I, too, believe that a parity of premiums is very important, at least at some point. In order to attract capital into this industry, the investors are going to have to be able to make an adequate return. They are going to have to believe that the Government is committed to letting this industry survive.

And that leads into the Federal Home Loan Bank equity and proposals to confiscate their capital.

I, too, believe that these Federal Home Loan Banks are owned by the industry. The industry has been very dependent upon these banks for their capital requirements—for their dividend stream. The action proposed in the administration's bill is going to severely dissipate that dividend stream, or at least have a serious impact on it.

Finally, I still continue to believe that in the long run, as long as there is an effective supervision and regulation of this industry, the losses will be minimized by not throwing a capital requirement on thrifts that they cannot achieve, in my estimation, in 2½ years. I don't think that the market will be able to raise the amount of capital required to recapitalize the industry. I am not even sure that the regulators will have the mechanisms in place to approve the merger requests that would be filed with them.

The CHAIRMAN. Let me ask you both one other question now before yielding to Senator Graham.

Many people have said to us that what the industry needs going forward is capital and good management, and of course, you both addressed different possible contradictions in the plan that might cut against either getting sufficient capital or attracting with the capital the management you might want to have to have a robust, well-run industry in the future.

Does it make sense conceptually if we define a savings and loan charter in the future centering around housing? Let's say housing is 70 percent of the activity, and then you have some wrap-around activities that would seem to fit with that, and that is in essence what the charter is going ahead.

If you had a more tightly written charter centering around housing, revamped regulatory structure, higher capital standards, what would be wrong with allowing banks, commercial banks, to be able to acquire savings and loans as long as they run them on this new definition of what a savings and loan is. Banks are in a very similar kind of a business, and they would certainly have management and to some extent capital assets to bring over to the thrift. Why shouldn't commercial firms—Ford Motor Co. is now in the savings and loan business—but why shouldn't we also look to other commercial enterprises that for one reason or another think they can make money in a traditional savings and loan type structure in the future, to encourage them to come on in as well, so that in effect you would enable either banks or other commercial entities to be able to acquire thrifts and run them in separate affiliates under a new structure, rule, supervision, with firewalls and protections against self-dealing and things of that kind?

Would that be a useful step for us to take? Would it help in the solution of this problem, in your viewpoints?

Yes, Mr. Treadway.

BANKS AND CORPORATIONS OWNING THRIFTS

Mr. **Treadway**. Well, I guess my first reaction to that is I start from a different sort of perspective. If the rate of return on originating and holding home mortgages is attractive on a risk adjusted basis so you don't have to be borrowing short to lend long to make a phony spread, there won't be a problem getting people to do it, and the savings and loan that are in existence now, the healthy ones, will very happily do that.

Now, it hasn't been that profitable, and part of the reason is because the Federal Government via FSLIC handed out what in effect was a substitute for capital. You didn't need capital to run a savings and loan. All you needed was a FSLIC guarantee. You could run it on a little bit of capital or negative capital.

I think if you enforce the capital regulations you are going to increase the rate of return on mortgages, and I think the market will provide a group of institutions, whether you call them banks or thrifts or whatever, that will very willingly engage in this business.

I think banks ought to be allowed to buy thrifts. I think that should be permitted.

I have to say I am still almost undecided about industrial corporations. If you make the return attractive, it isn't necessary to find industrial corporations with excess cash. The capital markets will raise the money.

It is interesting, roughly $6 billion, we estimate, was raised in various conversions from mutual forms since 1983. Those conversions could never have taken place had investors not been bribed to invest in the thrift stock, and they were bribed because they got the book capital that was already in the companies when they were in mutual form. It automatically went over to the new investors. The courts decided that that could happen that way.

So typically investors were convinced to buy stock. I participated in selling programs on these companies. You buy in at 70, 60, 50 percent of book, but to raise money at book value when the market is valuing thrift stocks, with only a few exceptions at roughly 70, 60, 50 percent of book.

If you put a dollar into a thrift as capital, a new dollar of capital in today at book value, it becomes worth 70 cents tomorrow. The rate of return is low.

That is the same reason—I am not commenting on whether the FSLIC got a little carried away in its deal making in December—that the FSLIC had to give a lot of "goodies" to investors to get them to put money in because the straight rate of return was too low. There is overcapacity in the industry. Ironically, there is undercapitalization because the FSLIC guarantee had substituted for capital.

And I hope with very tight capital requirements—and I am not too sympathetic to stretching out the compliance period too long—that will really force everyone to be on a level playing field and be adequately capitalized or raise stock, sell out or shrink down the institution.

The **Chairman**. Mr. Ferguson, did you want to add something before I yield to Senator Graham.

Mr. **Ferguson**. Yes, sir.

I think one of the most important, or probably the most important task before this committee is to get the cleanup process started. We do have overcapacity and the industry cannot make money. I might add I think we have the overcapacity in the banking industry as well and I think economic forces will take care of a lot of that.

But I believe that over a period of time that the real function of the industry will be further refined. In the proposed legislation you have a mandate to continue to study the functions of the entire financial industry, and I think that you will revisit this situation as time goes on and maybe put more constraints upon this industry as to what it is allowed to do and not allowed to do, but I think that you are not going to be able to get a very good picture of what this industry can or will do until you get the cleanup process actually underway. The situation is very, very critical; it is continuing to worsen every day that the issue is still being debated.

The CHAIRMAN. Apart from the high interest rate problem at the moment do you think the problem overall has worsened?

Mr. FERGUSON. Yes, sir, I think it has. An insolvent thrift—depending on the composition of its balance sheet, its interest earning assets and interest bearing liabilities, frequently has to continue to pay money to fund its operating expenses. So you borrow more money and you get to pay interest on that in the next year. This is continuing to deteriorate. These things will not cure themselves.

Maybe we have a better handle on the real estate losses. Maybe the problems are more clearly defined than they have been in the past, but the situation will continue to deteriorate.

The CHAIRMAN. Let me yield to Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

A basic question here—and I think Mr. Treadway, in response to one of the chairman's questions that you were raising this—is the degree to which the health of the housing industry is related to the continuation of a separate savings and loan industry.

If this industry were to phase into nonexistence by the end of the 1990's, what would be the consequences of that in terms of housing in America?

EFFECTS ON THE HOUSING INDUSTRY WITHOUT A SEPARATE S&L INDUSTRY

Mr. TREADWAY. Well, the market, the secondary market, the banks, the healthy thrifts today that I follow, many of them would change to bank charters, and they would still be in the business of originating and holding home loans, assuming of course that it was profitable to do so.

I don't see any problem or lack of capital for housing. If you want to subsidize housing, you create a special sector and give that sector some benefits. The benefits this sector has had is the Home Loan Banks. It used to have and still has a slightly more favorable tax treatment in terms of the bad debt reserve for holding mortgages.

What has been done is that the capital regs in this sector have not been applied equally. I mean, if you fall behind, nobody does anything to you.

So in that sense that is not good. I don't think there is any question—there is no question in my mind—that the housing sector would be well-served with funds.

If you remove the subsidy element, the rate, the mortgage rate would rise slightly, I would guess maybe between 10 and 30 basis points from where it otherwise would have been.

Senator GRAHAM. Your last sentence maybe has answered the next question I was going to ask, and that is to what extent have those benefits that have been made available to the S&L industry moved through to benefit the housing industry?

Mr. TREADWAY. I think they have lowered the cost of mortgage credit, and Fannie Mae and Freddie Mac and Ginnie Mae have also played a role here. I don't think there is any question about that.

It is hard to estimate just how much, but 10 basis points on the trillions of dollars we are talking about is not a small amount of money.

And again it is ironic to me that people are still advocating a separate housing industry, but in the same breath laying all these punitive measures. We are going from subsidizing the industry to punishing it with the President's proposal. There is a certain tradeoff here.

Senator GRAHAM. You used the phrase of "separate housing industry." You mean a separate housing——

Mr. TREADWAY. A separate thrift industry. I am sorry.

Senator GRAHAM [continuing]. Finance?

Mr. TREADWAY. I misspoke.

Senator GRAHAM. There has been some suggestion, Mr. Ferguson, that the plan of the administration, with its capital requirements particularly, is a plan for the dismantlement of the S&L industry, if you set standards that are beyond the capacity of the industry to reasonably attain that you are dooming it.

CAPITAL STANDARDS

Do you agree that that is the likely scenario of the capital standards and other provisions within the administration's plan?

Mr. FERGUSON. I believe that is a likely scenario for the greater number of institutions as well as assets in the industry. I just don't believe they would be able to meet those requirements, at least as independent entities.

Senator GRAHAM. You use the term, "the need to clean up the industry."

Do you think that is the kind of discipline which will accomplish that objective?

Mr. FERGUSON. I have absolutely no question or objection to the adequacy of the capital standards, or at least to the level of capital standards set forth in the administration's plan.

I am certainly not favoring lax supervision or inept regulation. I am just suggesting that you have a lot of people out there who have made bona fide business decisions over a long period of time depending on regulations that have been in existence and these decisions have been approved by the regulators, and all of a sudden we are changing the ballgame awfully fast.

Senator **Graham**. If you agree with the basic approach of increasing capital standards as a means of cleaning up the industry, are you suggesting that that ought to be stretched out over a longer period of time or otherwise modified?

Mr. **Ferguson**. I would suggest that 5 years would be much more appropriate than 2½ years. But let me also state that I suspect there are some institutions in that group that would not qualify by my criteria. I am suggesting they have to be well-managed, that they are properly supervised, they have had a clean examination history and appear to be operating in a safe and sound manner.

I am certainly not suggesting that the lower group in this industry, the ones in the neighborhood of 1.5 percent, 2 percent, even 2.5 percent, be allowed to try to grow their way out of their problems or have lax supervision that will enable this hole to get bigger.

Senator **Graham**. Mr. Treadway, if you would like to comment on what Mr. Ferguson has just said, I would like to also extend that.

If the effect of the capital requirements are going to be to eliminate a significant segment of this industry, do you believe that the numbers which the administration has recommended as required to deal with those institutions beyond the current 500 to 600 insolvents will be adequate?

Mr. **Treadway**. Well, there's several questions here. The first one, in cutting back and forcing the industry to meet capital requirements, will shrink the number of companies in the industry. There is an irony here, though, because as I mentioned before I think the industry has excess capacity, but it is undercapitalized. It is undercapitalized and it has excess capacity because the FSLIC guarantee substituted for capital.

As you shrink the industry back, you will increase the spread on mortgage lending. I think deposit rates will go down now and you will increase the profitability of the industry, and that will be a lure to bring capital into the industry.

So I am not displeased by the general concept of the administration's plan, which is really to shrink the industry. I don't know whether it will destroy the industry. I think it will actually make it more profitable for the one-third of the companies, or less perhaps, 20 percent, that remain, and they will be able to raise capital in the areas of the country where the industry has been wiped out in terms of capital, like Texas. We need to bring more capital back into the thrift industry there. There is definitely a demand, I think, for thrift services.

So, unfortunately, we have to be a little stern here and I think be very tough in applying these capital requirements. I don't know about stretching them out to 5 years. Two and a half years is tight. I am less sympathetic than Mr. Ferguson to the idea of stretching it out too much. Somehow it gets to be 5 years, and then there's exceptions.

You create the incentive for the undercapitalized companies—Financial Corp. of America was a classic example—where the Bank Board itself fell for this, where they decided to borrow short and lend long to get FCA out of its problems and they dug a deeper hole.

That is the problem. When you are undercapitalized, you don't have much to lose. So you try and throw the long bomb here to get away from it.

Now, you asked me a second question which, I am sorry, I have forgotten.

Senator **Graham**. The second question is if the consequence of increasing the capital standards is going to be to eliminate another slice of the industry.

The administration's financing plan focuses on the approximately 500 to 600 institutions that are either currently under Federal control, have recently come out of Federal control, or are anticipated to be in the near term under Federal control because they are currently insolvent.

The second slice are those institutions which are above the insolvent cases but are in the zone of jeopardy that will be created by the increased capital requirements.

Mr. **Treadway**. I personally believe——

Senator **Graham**. And my question is do you think there is enough money to deal with that second slice?

Mr. **Treadway**. Yes. I think there is a greater risk that if you let them go on, with low capital and there really may be no way for them to raise capital. So if you force them to sell out or shrink down the companies, the chances are you will wind up having to spend less money. What has happened already is that at least a substantial proportion of this middle tier will go into all kinds of activities to try and make the capital up with a lot of speculation. I think it will cost you more money that way.

Senator **Graham**. I was asking a slightly different question.

Assuming that we adopt the administration's capital plans——

Mr. **Treadway**. Yes.

Senator **Graham**. And I will editorially say that I agree that we need to impose that marketplace discipline that the requirement of reasonable capital will engender into the industry.

My concern is, has the administration's plan adequately recognized what the cost of that is likely to be in terms of the plan of salvation or, to put it another way, have they underestimated the total cost of the plan and as a result there may be more failures than are currently contemplated.

Mr. **Treadway**. I am sorry to take so long to get here.

The answer is probably. They probably have underestimated that.

There going to be additional insolvencies along the way here that have not, as I can see it, been fully allowed for, at least not in the initial proposals. I have seen all kinds of numbers in the press the last 2 weeks. It started at $90 billion and it is working its way up to $150 billion or more.

So certainly not, in the $90 billion.

Senator **Graham**. Yes, Mr. Ferguson.

Mr. **Ferguson**. Senator, when you take approximately 20 percent of an industry that numbers over $300 billion in assets out of total industry assets of about $1.3 billion—they are insolvent, massively insolvent and they are contributing to this overcapacity that we have in the industry today. Then they so severely taint, in my opinion, the healthy part of the industry as well as the thrifts in this group that I call solvent but undercapitalized that these institutions are not doing so well either.

Even the solvent and well-capitalized thrifts today are not doing as well as their commercial banking counterparts. Again, I think it is because of the taint that exists from this substantial part of the industry, that is insolvent.

I really think that it is going to take a year or two to get these insolvent thrifts resolved. That can't be done overnight. It is a long, slow process. It is going to take a lot of human resources. It is going to take a lot of financial resources.

But I, during that period of time, if the solvent but undercapitalized thrifts are put on notice that they will have a drop-dead date to get their capital in line, then, at least, the operating environment will have improved sufficiently to enable a lot of them to take care of their own problems.

Senator GRAHAM. Before I leave that question to go to a couple of others, one suggestion that has been made, either if we stay with the administration's date of 1991 for meeting the 6-percent capitalization or if we stretch it out, that there should be a glide slope; that is, that you don't go from wherever you are to a single date and immediately be held to 6 percent, but rather that there will be milestones starting now with 6 percent as the ending date so that institutions will be forced to on a consecutive basis be meeting higher and higher capital standards until they get to the level.

What would you think of that suggestion?

Mr. FERGUSON. I would certainly be supportive of that suggestion. I think it is reasonable.

Mr. TREADWAY. I would agree. I don't have a problem with that. That is probably necessary to do it that way.

I think the main thing is that—I like that term "drop dead."

The industry has to know that the capital requirements are really serious instead of the old forbearance route and, you know, when the moment of truth comes, the regulators back down.

So even under a 5-year scenario, if it were really enforced, with maybe some milestones along the way, that would do the job.

Senator GRAHAM. But let me move to a second issue, and that is the basic financing approach of this plan. Both of you have recommended that the direct Treasury borrowing would be your preference to the borrowing proposed under this plan, is that correct?

Mr. TREADWAY. That is correct in my case.

Senator GRAHAM. Yes. Mr. Treadway and Mr. Ferguson are both nodding affirmatively.

Mr. FERGUSON. Yes.

Senator GRAHAM. Are there any other changes within the shape of that Treasury borrowing; for instance, the 30-year recommendation or any other modifications? Should it be shifted directly into the Treasury?

If our goal is to finance this plan on the least cost basis, what would be your recommendations as to how to accomplish that in addition to the recommendation of having it financed directly by the Treasury?

Mr. **Treadway**. Well, there is nothing sacred about 30 years. So I think you have hit on another benefit of having the Treasury do it as part of its regular program. They would have that flexibility, and it will probably lower the costs.

If that is your point, I agree with that.

Mr. **Ferguson**. I agree with Mr. Treadway.

Senator **Graham**. On the issue of the Federal Home Loan District Banks, Mr. Treadway, in your testimony you cite on summary pages 2 and 3 that:

"If the banks are liquidated, the Federal Home Loan Bank should pay off their thrift owners."

Has there been a time in the past when the thrifts have not been paid back by the Government?

Mr. **Treadway**. Yes, there is, the famous secondary reserve issue of several years ago where the accountants made the thrifts write off their secondary reserve interest in the FSLIC insurance system.

Now, under the Competitive Equality in Banking Act, that was actually restored to the thrifts over a 6-year period.

So there has been in a sense a default here, not in a legal sense but in an economic sense, although Congress later is restoring it.

Senator **Graham**. I have no further questions. I wish to express on behalf of the chairman and the other members of the committee our appreciation for your very helpful testimony.

The meeting is adjourned.

Thank you.

Mr. **Treadway**. Thank you.

[Whereupon, at 12:41 p.m., the committee was adjourned, subject to the call of the Chair.]

PROBLEMS OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION [FSLIC]

PART III OF IV

TUESDAY, MARCH 7, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Cranston, Sarbanes, Dixon, Sasser, Shelby, Graham, Wirth, Kerry, Bryan, Garn, Heinz, Gramm, Bond, Mack, and Pressler.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me welcome our witnesses this morning and I'm sure that with the Tower matter before the Senate and other hearings going on, as well as the weather, we will have members coming and going at different hours this morning.

I have a brief opening comment to make and then will call on my colleagues and then we will hear from our witnesses.

Today is our 11th day of hearings on the problems facing the savings and loan industry and the insurance fund. After 2 weeks of testimony from the administration and the bank regulators, today the committee turns its attention to reactions and the inputs from a wide variety of directly interested parties and associations. No groups are more directly affected by the administration's proposal than the U.S. League of Savings Institutions and the National Council of Savings Institutions, and today we will hear from their representatives.

Over the next few weeks we will also be hearing from other thrift, banking and financial associations, as well as consumer groups, State regulators, the home builders, realtors, mortgage bankers, and representatives of credit union associations. That will complete our hearing schedule.

It is our continuing intention to complete that hearing schedule on time, use the Easter recess period as a period to develop a committee print to bring to a markup in the committee right after the Easter recess, and secure an early slot on the Senate floor once the committee has acted so that we can take the matter before the full Senate.

So we are very much on our timetable and we intend to stay on that timetable.

It's often been said that traditional thrifts, those emphasizing most clearly home finance in their lending, and primarily dealing with individuals, have in recent years generally remained profitable and competitive. It is also often said that the largest losses have been concentrated in institutions that have moved away from home lending and aggressively exploited some new or broadened powers provided them especially by some States.

I have said before and I repeat again, I think it's significant that in 1988, 59 percent of all S&L losses occurred in just 2 States—Texas and California, with Texas amounting to fully 50 percent or ½ of the total industry loss. In the prior year, 1987, 50 percent of the industry losses were also from just those 2 States with what are thought to be much more generous State powers as add-ons to what the Federal charter allows.

The facts I think are very clear in terms of the concentration of where the problem is and there I think is a clear relationship that we can start to track back to where these savings and loans have directed their principal attention.

During 1987 and the first three-quarters of 1988, the fourth data of course have not been released yet—thrifts that had more than 50 percent of their assets in single family mortgages were profitable. By comparison, those with less than 25 percent in single family mortgages lost money at a rapid rate. Given the profitability of the traditional thrift, I believe that Congress should take steps to reemphasize the housing component of the thrift charter. If we are to preserve this specialized and subsidized institution, the qualified thrift lender test which measures a thrift institution's involvement in housing finance, in the view of this Senator, should be strengthened and increased.

At the same time, the focus of the charter should be more sharply directly toward meeting the needs of the individual, the family, the consumer, and the community. In this regard, I agree with those in the administration who argue that as our financial institutions grow more global and regional in nature. There is an ongoing need for a specialized institution devoted primarily to local residential housing finance and to community development.

Our witnesses this morning represent a wide variety of thrift institutions, including both traditional savings and loan associations as well as highly diversified institutions.

One criticism of the administration's proposal that both trade associations share regards their assertion that the insurance fees that are proposed to be paid by their member S&L's are too high and therefore threatening in the future.

We will also hear that the proposed capital standards in the bill are thought to be too tough and have to be reached in too short a timeframe. So we will have, of course, a discussion on those particular issues as the morning unfolds.

In the past, the national thrift industry has not done a good job, in my view, of addressing its problems and policing itself. National savings and loan industry associations could have and should have been aggressive in calling for needed reforms that could have, at least in part, helped prevent this financial catastrophe which is very damaging to the country and threatening to the survival of the industry itself.

I would encourage our witnesses this morning not to in any way exaggerate their concerns or to downplay them. I think this is the time for the plainest kind of direct talk, in terms of what's to be done, in terms of getting this industry resurrected and back on its feet financially, and the insurance system that goes with it.

So I am very much interested in the recommendations that we will hear today. I think that it's very important that they go directly to the issues that we have to resolve together.

With that, let me yield to my colleague, Senator Garn.

OPENING REMARKS OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

Gentlemen, I'd like to welcome you here today. Mr. Beeksma comes from Oak Harbor, WA, and I sympathize with his having to come to Washington, DC from Oak Harbor. As a young naval officer, I was stationed there and my second child's first daughter was born in Oak Harbor. So I know the beauties of where you live and the transition to Washington is considerable. I understand that.

First of all, let me apologize for having to leave for at least part of your testimony. Secretary Brady is testifying before the Appropriations Committee at 10:30 so I will have to leave for his testimony and then I will try and get back before you leave.

Second, in the interest of time, Mr. Chairman, I would ask unanimous consent that my statement be put in the record.

The CHAIRMAN. Without objection.

PREPARED STATEMENT OF SENATOR GARN

Mr. President, I would like to add my name as cosponsor to the legislation that Senators Cranston and D'Amato are introducing today, the Depository Institutions Affiliation Act. Let me provide a few brief remarks as to why I am doing so.

A few weeks ago, I cosponsored legislation, S. 305, with Senator Dixon and others that would repeal key elements of the Glass-Steagall Act—legislation that is virtually identical to the Proxmire Financial Modernization Act of 1988 that passed the Senate by an overwhelming margin last year, only to die in the House of Representatives. I think that legislation represented a solid, workable compromise that a consensus of members obviously could support in this difficult area of financial services competition. If enacted, it clearly would have been a great step forward toward making our financial services industry more competitive both domestically and internationally.

S. 305 also adopted the holding company structure as the vehicle for allowing affiliations among differing types of financial institutions. I continue to support that structure as a way to enhance competition, to isolate institutions benefiting from deposit insurance from inappropriate risks, and to protect against unfair competition.

But as I said recently when S. 305 was introduced, I do not support every aspect of the legislation. There were concepts that I agreed last year to drop or compromise as the final legislative product was hammered out. Some of those concepts may need to be revisited, especially in light of the changes that have occurred in the financial services marketplace just since last year's compromises were agreed upon.

Today I am cosponsoring the Depository Institutions Affiliations Act because I believe it raises issues that must now be addressed if we are to proceed responsibly in the area of financial structure reform.

As an example, the legislation fashioned by Senators Cranston and D'Amato raises the issue of how best to provide the vast amounts of capital that will be needed by our financial services industry. The Cranston/D'Amato Bill would open the option of allowing that capital to be raised through investments by corporations that are not today allowed to invest in certain segments of our financial services industry.

The Cranston/D'Amato Bill also directly raises the issue of how best to assure the competitive viability of America's financial services providers in the face of intensified international competition that will result from developments like the competitive structure being put in place for Europe 1992.

In brief, Mr. President, while I do not endorse all of the elements of the Depository Institutions Affiliation Act, I am cosponsoring this bill because I believe that it raises important issues that Congress must soon address if we are to assure the health and competitiveness of America's financial services providers both at home and in the increasingly important international financial services marketplace.

Senator GARN. I would only summarize it with one brief paragraph, that your testimony isn't totally surprising to me, particularly the U.S. League's. It can be summed up in the following manner. Make the taxpayer pick up more of the burden. Give us forbearance to meet capital standards. Don't touch our Government-sponsored Federal Home Loan Banks and leave our regulator alone.

And respectfully, I disagree on all four points.

The CHAIRMAN. Thank you, Senator Garn.

Senator Cranston.

OPENING STATEMENT OF SENATOR CRANSTON

Senator CRANSTON. I'll be very brief. I welcome the witnesses that are before us this morning.

This is a tough time for our depository institutions and for those particularly who have stuck with their knitting and run their institutions well throughout this incredible crisis.

We've all had a look at the administration's plan. It anticipates A $36.7 billion contribution from the thrift industry over 10 years to help defray the costs of the free ride some in the industry have had that now has to be paid for. It's clear that all are going to have to pay some share—the industry, the Government, the taxpayer—perhaps other entities.

The administration plan depends on the majority of the thrift industry remaining healthy to pay future anticipated insurance premiums into the system to cover the cost of the financing of the plan. But we must recognize that if we take too many of the assets of the healthy thrifts, they won't be around to cover the costs of this remedy and the taxpayer will then have to bear a much larger burden. A confiscatory tax that makes the healthy thrifts fail will scare away any new capital from coming into the industry in the future.

We in Congress have another matter we have to watch carefully. We want to make sure that the industry pays all it can afford to pay into any plan of course, but we have a responsibility to preserve the thrift industry's role as a principal leader for housing finance. That will not occur if we destroy the industry or legislate it out of business and I think we must not do that.

I question a number of aspects of the administration's proposal. Frankly, I also question every other plan that's been suggested in one way or another. So we have our work cut out for us. I look forward to the advice and comments of those who will testify today.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Cranston.

Senator Heinz.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, I join you in welcoming today's witnesses. They represent our Nation's thrift industry and in some respects they are concerned, as I skimmed their testimony, that the President's plan may be gambling with the future of the thrift industry.

However, as I understand it, they are equally concerned with the amount of money that the industry will have to ante up. With more than $100 billion on the table, there's no doubt that this is a very high stakes game.

The thrift industry trade groups are here to put their cards on the table. The ones at this table represent the survivors, the S&L's that played by the rules. The others in the industry were the gamblers and the cheaters who were playing with insured deposits. Those high rollers ran up huge losses and left the FSLIC holding about $100 billion of IOU's. Mr. Chairman, it's my view that the time has come to stack the deck in the Government's favor. We need to make sure that the next time that the cards are dealt the Federal Deposit Insurance Corporation gets a winning hand. We have also got to make clear that placing savings in an insured account is still a safe bet and it will always be one. When it comes to protecting the safety and soundness of our financial institutions we can no longer afford to let the chips fall where they may.

The CHAIRMAN. Thank you, Senator Heinz.

Senator Wirth.

Senator WIRTH. I thought that Senator Heinz represented Pennsylvania and not Nevada.

The CHAIRMAN. You notice he did get the attention of Senator Bryan on that one.

Senator WIRTH. Senator Bryan was hiding. So was I.

Senator HEINZ. Senator Bryan was passing me notes. [Laughter.]

OPENING STATEMENT OF SENATOR WIRTH

Senator WIRTH. Thank you, Mr. Chairman.

I was struck with Senator Garn's opening comments and I think that that is a very sobering signal to us. I have difficulty understanding how this industry can, having advocated all of the rapid deregulation and change which we have seen and which has proven to be I think in many cases simply a disaster, can come in and say, as I understand your testimony, no changes are going to be necessary. I just don't understand how that's possible.

Now I've not been one, as you all know from my days in the House, that advocated the deregulation of the savings and loan industry. I voted against it. I thought it was a bad idea. I met with a lot of your people about it and a lot of your people agreed that it was a bad idea, but the association went charging down the road advocating and pushing all of these changes.

Now we're back in the remarkably difficult situation of a huge tab to the taxpayer—I mean huge—capital H, big cards, stack of chips this high, and the CBO told us last Friday that this might be as much as $100 billion plus, double what the administration is suggesting.

Now the backlash to this politically, the backlash to this from the taxpayers of the country, is justifiably going to be huge as well—we saw a backlash in Maryland and we saw a backlash in Ohio. It seems to me that is tiny compared to what we're going to see coming back when the size and scope of this problem gets out and the taxpayers who are being asked to pull in their belt in one place and another.

It's in that context of the size of this of an association that I understand was in here advocating enormous deregulation now to come in and say in the face of the disaster and this enormous taxpayer cost, don't make any changes. I think that Senator Garn's opening comments are going to resonate for a long time.

I would just be interested in hearing how you can, as I read the testimony—maybe I misread it, but how you respond to the comments made by the distinguished Senator from Utah. I'm pleased you are here and, as Senator Riegle said, we ought to have this all right out in the open. And it's time for very blunt, tough talk because we've got to put a bill together and that's going to be expensive and you all are going to have to be involved in helping on that, not resisting.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Wirth.

OPENING REMARKS OF SENATOR BRYAN

Senator BRYAN. Thank you, Mr. Chairman.

I share the concerns that have been voiced here this morning by Senator Garn and Senator Wirth. Reading the testimony as I did last night, I was frankly somewhat shocked by the tone.

This committee faces a very, very difficult challenge of picking up the pieces, trying to develop a plan. There are clearly going to be some modifications from the administration's plan. I think everyone on this committee recognizes that. I had frankly hoped that the savings and loan industry would come before us and offer some constructive suggestions and comments where we could strengthen the bill.

In effect, what I see is the same thing that Senator Garn sees—don't change anything, we're not part of the problem at all, let's have business as usual. And speaking for one member of the committee, that's not my approach and that's not the way I'm going to be voting on this measure.

The CHAIRMAN. Thank you, Senator Bryan.

Senator Mack.

OPENING REMARKS OF SENATOR MACK

Senator MACK. Thank you, Mr. Chairman.

I, too, welcome you and look forward to your testimony and my particular concerns are the impact of the capital requirements on the industry. I am also concerned about what the financial market will look like when we get through putting this plan together.

I look forward to your testimony and an opportunity to raise some questions later.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Mack.

Let me now introduce our witnesses and then we'll take them in order.

First will be Mr. Barney Beeksma, who is the chairman of the U.S. League of Savings Institutions and who also serves as the chairman and president of InterWest Savings Bank in Oak Harbor, WA. He is accompanied by Mr. Kenneth Seaton, who is the vice chairman of the U.S. League of Savings Institutions and who is the chairman of Detroit and Northern Savings Bank from Hancock, MI. I am particularly pleased to have Mr. Seaton here as a Michiganite today. Our second witness will be Mr. Charles Koch, who is the chairman of the National Council of Savings Institutions, who is president and CEO of the First Federal Savings Bank in Cleveland, OH.

Now, gentlemen, we've got your full statements. We will make your full statements a part of the record. As we go, it would be helpful to us if you would summarize as much as you can and really go to the critical points that you want to stress and that you know are of key interest to us. I know there will be a lot of questions that the members have and we want to be able to have plenty of time for a good full exchange.

So with that, Mr. Beeksma, we'd be pleased to hear from you now.

STATEMENT OF BARNEY R. BEEKSMA, CHAIRMAN, U.S. LEAGUE OF SAVINGS INSTITUTIONS, CHAIRMAN AND PRESIDENT, INTERWEST SAVINGS BANK, OAK HARBOR, WA, ACCOMPANIED BY KENNETH D. SEATON, VICE CHAIRMAN, U.S. LEAGUE OF SAVINGS INSTITUTIONS, CHAIRMAN, DETROIT AND NORTHERN SAVINGS BANK, HANCOCK, MI; KENNETH ROSEN, UNIVERSITY OF CALIFORNIA AT BERKELEY; AND JONATHAN GRAY, SANFORD, BERNSTEIN & CO.

Mr. BEEKSMA. Thank you very much, Mr. Chairman and members of this distinguished committee. I am Barney Beeksma and I am here today in my capacity as chairman of the U.S. League of Savings Institutions. In addition to Ken Seaton who accompanies me, we have two expert witnesses who are here to respond to any questions you may care to direct to them. We have Mr. Kenneth Rosen, who heads the Real Estate Research Department at the University of California at Berkeley; and Mr. Jonathan Gray, who is a research analyst with Sanford, Bernstein and Co.

We are here, Mr. Chairman, to address S. 413 and I'm looking forward to the opportunity to respond to the questions that you will present to us this morning.

This of course is the administration's proposal for resolving the crisis in the Federal Savings and Loan Insurance Corporation and restructuring the savings institutions' regulatory, supervisory, and deposit insurance systems.

We are here as well, Mr. Chairman, to provide our views on how the Congress might ensure that never again can such a situation as this develop in our system of commercial banks, savings institutions and credit unions.

Let me add as well, Mr. Chairman, that we do applaud the administration for coming forth with this bill. The Washington Post had an article this morning basically characterizing our position as opposing the bill. We do not agree with that. We applaud the administration for coming forth with this bill. This bill is now in the legislative process. Congress is going to shape this bill and we simply seek an opportunity to add some modifications to this bill which we think will assure our survival. We want to participate in that legislative process and to that end we appear before you today. We thank you for that opportunity.

Members of this committee certainly are well aware of the lynch mob mentality that's rampant today. It threatens the innocent and the healthy majority of institutions along with the handful of scoundrels who so outrageously abused the public's trust and the thrift charter. This has got to end, Mr. Chairman, and it must end before our Nation's mortgage credit delivery system is destroyed through misdirected vengeance.

Working together, we think we can do that. We can end this nightmare and we can return our energies fully to the mission for which we were created. But our watchword in this process must be "never again", and to that end the U.S. League submits the following.

In order that "never again" be more than a slogan, the U.S. League strongly supports the following program. We seek stringent Federal supervision by an adequately staffed force of well-trained, well-paid professionals to police the financial sector.

We support giving the Department of Justice whatever resources it requires to swiftly prosecute lawbreakers and to obtain restitution of the ill-gotten gains.

We also support additional regulatory enforcement tools. We support strong capital requirements identical for all depository institutions, be they commercial banks, credit unions, or savings and loans.

We endorse risk-based capital guidelines phased in over an appropriate period of time and with appropriate grandfathering.

We endorse the use of GAAP accounting standards by all types of financial institutions.

In that a strong housing focus is the hallmark of the successful savings institution in the 1980's, we support continuation of the Federal Home Loan Bank Board and the Federal Home Loan District Banks as separate, independent, and autonomous entities.

To continue a specialized housing finance function, our business absolutely must build capital both through profits and through appeal to outside investors. Aware as we are that we will be a source of a portion of the funds necessary to meet the FSLIC shortfall, we seek only to make our contribution at a level that will not be so burdensome as to weaken our institutions and thus exacerbate further the current deposit insurance crisis.

As proposed in S. 413, the deposit insurance premium structure, combined with the loss of Federal Home Loan Bank System dividends, collides with the absolutely vital objective of obtaining higher capital standards. We urge Congress to examine the administration's proposal closely for we fear that great dangers lie within it.

Specifically, placing the Federal Home Loan Bank System under the Treasury endangers a vital source of capital to housing finance.

Specifically, eliminating the Federal Home Loan Bank Board and radically changing the role of the Federal Home Loan Bank System threatens continuation of our system of specialized housing lenders.

Heavy premiums for insured deposits and a reduction in the earnings on the business' investment in the Federal Home Loan Bank System makes it all the more difficult for savings institutions to build capital. Meager profits make it more difficult to attract new outside capital. The inability to build higher capital levels will make it impossible for depositories to hold mortgages to the extent they would have under other circumstances. Plus, very simply, if we cannot compete because of the excess burden placed upon us, we will not be able to meet the growth projections which are contemplated in the premium flow to the insurance funds.

Having had an administrative merger of the deposit insurance funds thrust upon us, we accept the inevitable and we call for bringing this process to its logical conclusion—a full merger of the deposit insurance funds.

As part of such a full merger, the Congress should provide that thrifts and commercial banks be given identical FDIC insurance logos, by some date certain thrifts and commercial banks should pay the same Federal deposit insurance premiums, and future premiums going forward from thrifts and commercial banks be commingled so that all such funds reduce taxpayer costs.

Above all, Mr. Chairman, justice must prevail—justice for the prudent and the healthy institutions, as well as justice for the high rollers and the crooks. We trust this committee will move swiftly toward that goal. I thank you.

[The complete prepared statement of Barney R. Beeksma follows:]

SUMMARY

Testimony of Barney R. Beeksma
Chairman, U.S. League of Savings Institutions
U.S. Senate
March 7, 1989

We must ensure that never again can a situation such as the current FSLIC crisis develop in our system of commercial banks, savings institutions and credit unions. Working together, we can do that, but it must not be to the detriment of healthy savings institutions and the housing delivery system they support.

We seek stringent federal supervision by an adequately staffed force of well-trained, well-paid professionals to police the financial sector. We support giving the Department of Justice whatever resources it requires to swiftly prosecute lawbreakers and to obtain restitution of ill-gotten gains. We also support additional regulatory enforcement tools.

We support strong capital requirements, identical for all depository institutions, be they commercial banks, credit unions or savings institutions. We endorse risk-based capital guidelines phased in over an appropriate period of time and with appropriate grandfathering. We endorse the use of GAAP accounting standards by all types of financial institutions. As proposed in S. 413, the deposit insurance premium structure combined with our loss of Federal Home Loan Bank System dividends collides with the absolutely vital objective of attaining higher capital standards.

In that a strong housing focus is the hallmark of the successful savings institution of the 1980s, we support continuation of the Federal Home Loan Bank Board and the Federal Home Loan District Banks as separate, independent and autonomous entities.

To continue its specialized housing finance function, our business must build capital, both through profits and through appeal to outside investors. Aware as we are that we will be the source of a portion of the funds necessary to meet the FSLIC's shortfall, we seek to make our contribution at a level that will not be so burdensome as to weaken our institutions and thus exacerbate further the current deposit insurance crisis.

We urge Congress to examine the Administration's proposal closely, for we fear that great dangers lie within it. Specifically:

Placing the Federal Home Loan Bank System under the Treasury endangers a vital source of capital to housing finance. Eliminating the Federal Home Loan Bank Board and radically changing the role of the FHLB System threatens continuation of our system of specialized housing lenders.

Heavy premiums for insured deposits and a reduction in the earnings on the business's investment in the Federal Home Loan Bank System make it all the more difficult for savings institutions to build capital. Meager profits make it more difficult to attract new, outside capital. The inability to build higher capital levels will make it impossible for depositories to hold mortgages to the extent they would have under other circumstances. As a result, less mortgage money will be available and housing will be denied to millions of households. A disparity in premiums between thrifts and their commercial banking competitors places thrifts at a competitive disadvantage.

Having had an administrative merger of the deposit insurance funds thrust upon us, we accept the inevitable and merely call for bringing this process to its logical conclusion -- a full merger of the deposit insurance funds. As part of such a full merger, the Congress should provide that: (1) Thrifts and commercial banks be given identical FDIC insurance logos; (2) By some date certain, thrifts and commercial banks pay the same federal deposit insurance premiums; and (3) Future premiums from thrifts and commercial banks be commingled so that all such funds reduce taxpayer costs.

The argument for changing the District FHLBanks' Boards of Directors composition is based on false fear of conflicts of interest. Boards are strictly prohibited from discussing supervisory matters. Further, under the Administration proposal the District Bank presidents would no longer perform a supervisory role. Thus, member institutions -- the stockholders -- should have the majority voice in the Boards of Directors of FHL District Banks.

Our investment in the Federal Home Loan Bank System must not be contaminated. If the FHLBS is going to be used as a funding source for the FSLIC shortfall, the stock requirements for members should be changed to equate to those of regional Federal Reserve Banks.

Justice must prevail -- justice for the prudent and healthy institutions as well as justice for the highrollers and the crooks.

Imagine, if you can, the pain the honest manager of a healthy institution suffers when he or she is lumped together with the handful of crooks and highrollers who looted their companies;

. . . the pain we suffer when we are portrayed as greedy usurers out to hoodwink the taxpayer into "bailing out" our healthy businesses;

. . . the pain of paying 2 1/2 times for the same deposit insurance our commercial bank competitors pay, and then having them imply to our customers that our guarantee of safety is somehow second-rate;

. . . the pain of seeing our role as builders and defenders of this nation's neighborhoods and communities degraded by the cynicism of those who question whether thrifts still play a significant role in housing finance...by those who would carry their hostility to specialized mortgage lending to the destructive extreme of dismantling the savings institution structure by crippling the Federal Home Loan Bank System;

. . . and the pain we suffer and see in others -- in longtime loyal customers who are caused to worry needlessly about the safety of their life savings.

Members of this Committee are well aware that the lynch-mob mentality is rampant today, unjustly threatening the innocent majority along with the handful of scoundrels who so outrageously abused the public's trust and the thrift charter. This must end before our nation's mortgage credit delivery system is destroyed through misdirected vengeance.

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Thank you, Mr. Chairman, and members of this distinguished Committee. I am Barney R. Beeksma, Chairman and Chief Executive Officer of InterWest Savings Bank of Oak Harbor, Washington. I am here today in my capacity as Chairman of the U.S. League of Savings Institutions.

Accompanying me is Kenneth Seaton, the U.S. League's Vice Chairman, who is also chairman of D&N Savings Bank of Hancock, Michigan.

We're here, Mr. Chairman, to address Senate Bill 413, the Administration's proposals for resolving the crisis in the Federal Savings and Loan Insurance Corporation and restructuring our savings institutions' regulatory, supervisory and deposit insurance systems.

We're here as well, Mr. Chairman, to provide our views on how the Congress might best ensure that never again -- as Secretary Brady so eloquently put it during his appearance before you two weeks ago -- can a situation such as this develop in our system of commercial banks, savings institutions and credit unions.

As this Committee well knows, the thrift industry suffered huge losses as a result of the deregulation and record interest rates of the early 1980s. Many institutions saw the capital they had accumulated over decades disappear virtually overnight as the result of poorly timed deregulation.

The shock of the badly timed and poorly managed deregulation process (where the liability side of our balance sheet was deregulated before we had a chance to restructure the predominantly fixed-rate asset side) and the availability of new investment authorities authorized both at the state and the federal levels also created an identity crisis for many institutions. As a result, some -- fortunately a minority -- abandoned their roots and turned away from housing finance.

More importantly, the vast new powers provided to thrifts by some states, the removal of a variety of barriers to purchase of a thrift by a single individual, and the desire of regulators to accommodate the acquisitions of thrifts attracted many new players into the industry.

Most members of the Committee already recognize that as of mid-1988 just 25 badly insolvent companies accounted for roughly one-half of the negative GAAP capital of those firms that have failed. What you may not realize is that more than one-half of these 25 problem cases were newly chartered or experienced a change of control in the early 1980s. In other words, with the consent of federal regulators, new and imprudent owners took over and ran these firms in a nontraditional manner.

As a result of the huge losses produced by this small number of renegade thrifts, our industry now suffers from much more than just the need to restore its capital base. Conventional wisdom seems to be that even healthy thrifts that had no part in the abuses must feel the pain of punishment. Believe me, Mr. Chairman, we have been feeling and continue to feel that pain.

Imagine, if you can, the pain the honest manager of a healthy institution suffers when he or she is lumped together with the handful of crooks and highrollers who looted their companies;

. . . the pain we suffer when we are portrayed as greedy usurers out to hoodwink the taxpayer into "bailing out" our healthy businesses;

. . . the pain of paying 2 1/2 times for the same deposit insurance our commercial bank competitors pay, and then having them imply to our customers that our guarantee of safety is somehow second-rate;

. . . the pain of seeing our role as builders and defenders of this nation's neighborhoods and communities degraded by the cynicism of those who question whether thrifts still play a significant role in housing finance...by those who would carry their hostility to specialized mortgage lending to the destructive extreme of dismantling the savings institution structure by crippling the Federal Home Loan Bank System;

. . . and the pain we suffer and see in others -- in longtime loyal customers who are caused to worry needlessly about the safety of their life savings.

Members of this Committee are well aware that the lynch-mob mentality is rampant today, unjustly threatening the innocent majority along with the handful of scoundrels who so outrageously abused the public's trust and the thrift charter. This must end, Mr. Chairman. It must end before our nation's mortgage credit delivery system is destroyed through misdirected vengeance.

Working together, we can do that. We can end this national nightmare and return our energies fully to the mission for which we were created. But our watchwords must be "never again," and to that end the U.S. League submits the following.

Never Again - Cops, Capital, Housing & Profit

In order that "never again" be more than a slogan, the U.S. League strongly supports a four-point program, as follows:

(1) Cops: We seek stringent federal supervision by an adequately staffed force of well-trained, well-paid professionals to police the financial sector. We support giving the Department of Justice whatever resources it requires to swiftly prosecute lawbreakers and to obtain restitution of ill-gotten gains. We also support additional regulatory enforcement tools, such as those contained in S. 1886, developed by this Committee and approved by the Senate last year.

(2) Capital: Recognizing that real capital is the ultimate protection against risk, we support strong capital requirements, identical for all depository institutions, be they commercial banks, credit unions or savings institutions. We endorse risk-based capital guidelines phased in over an appropriate period of time and with appropriate grandfathering. And further, we endorse the use of GAAP accounting standards by all institutions.

(3) Housing: In that a strong housing focus is the hallmark of the successful savings institution of the 1980s, we support continuation of the Federal Home Loan Bank Board and the Federal Home Loan District Banks as separate, independent and autonomous entities.

(4) Profit: To continue its specialized housing finance function, the savings institution business must build capital, both through profits and through appeal to outside investors. Aware as we are that we will be the source of a portion of the funds necessary to meet the FSLIC's shortfall, we seek to make our contribution at a level that will not be so burdensome as to weaken our institutions and thus exacerbate further the current deposit insurance crisis.

Savings Institutions' Role in Housing Finance

We applaud President Bush and the Congress for moving so early in the present term to resolve the FSLIC crisis. We are particularly grateful for the Bush Administration's recognition of our business's significant role in housing finance. To quote Treasury Secretary Brady from his statement to this Committee on February 22nd:

> "Today, as in the past, the S&L industry plays an important role in housing finance. The S&L industry's problems do not stem fundamentally from their traditional business of mortgage financing."

Secretary Brady is exactly right when he points out that those thrifts that have stayed with housing finance have not caused the current problems. It was those who deserted mortgage finance who produced these huge losses. Secretary Brady continued:

> "We believe the best thing for housing finance in this country is a strong and sound S&L industry."

These are reassuring words for us, coming as they do at a time when our basic role as an instrument of national housing policy is being questioned. We recognize that the revolution in mortgage finance of the 1980s has created numerous misunderstandings concerning the significance of thrifts in housing finance. It is also obvious that those critics who never have believed in specialized mortgage lenders or the social priority they represent have used the confusion surrounding the changes in our housing finance system and the problems of the FSLIC to advance their own special interests.

To set the record straight, I want to make a few brief points concerning the role of thrifts in residential mortgage finance.

There are essentially three main ways to evaluate the role played by housing finance specialists: (1) Their share of residential mortgage loan originations; (2) Their share of residential mortgage loans outstanding; (3) The percentage of portfolio they dedicate to residential assets.

On all three counts, savings institutions unquestionably focus on housing the American people.

Our savings and loans and savings banks accounted for nearly one-half of all mortgage loan originations in 1988. This was more than twice the market share of our closest competitor group, the commercial banks. And while our market share is high, it soars well beyond 50% when savings institutions are credited with mortgages originated by their mortgage banking subsidiaries.

As Table 1 shows, savings institutions now hold 49% of all outstanding whole conventional home mortgage loans and 32% of all outstanding mortgage-backed securities. Combined, then, we hold 42.8% of all single-family loans and mortgage-backed securities. Commercial banks, again our closest competitor group, had holdings of only 18.8%. This better than two-to-one ratio in dollar holdings has been maintained in spite of the fact that commercial banks have 2 1/2 times our total assets and office locations. Should our specialized institutions somehow disappear, the question must be asked: Who will pick up our current holdings? Clearly, our institutions, as holders of these loans, are essential to homeownership.

TABLE 1: SAVINGS INSTITUTIONS ARE THE MAJOR HOLDERS OF SINGLE-FAMILY MORTGAGE LOANS & MORTGAGE-BACKED SECURITIES

Percent of Total, September 1988

(3)	Single-Family Whole Loans	Mortgage-Backed Securities	Total
Savings Institutions (1)	49.0%	32.0%	42.8%
Commercial Banks	23.0%	11.4%	18.8%
Life Insurance Companies	1.1%	13.9%	5.8%
FNMA & FHLMC	8.3%	N.A.	5.2%
Individuals	4.4%	3.8%	4.2%
State & Local Credit Agencies	3.9%	N.A.	2.5%
State & Local Pension Funds	0.3%	5.9%	2.3%
Finance Companies	3.3%	N.A.	2.1%
Private Pension Funds	0.1%	5.0%	1.9%
Credit Unions	2.6%	0.2%	1.7%
Federal Government (direct)	1.7%	N.A.	1.1%
Mortgage Companies	1.7%	N.A.	1.1%
REITs	0.0%	1.9%	0.7%
Other (2)	0.5%	25.9%	9.8%
TOTAL	100.0%	100.0%	100.0%

*N.A. - not available
(1) Includes savings and loans and savings banks
(2) Includes investment bankers and foreign investors.
(3) Single-family whole loans and mortgage-backed securities.
Source: Department of Housing & Urban Development, Federal Home Loan Bank Board, Federal Reserve Board, Investment Company Institute, Credit Union National Association, National Association of REITS and Pension and Investment Age.

Further, it is important to note that, contrary to what some would have you believe, the asset composition of thrifts differs greatly from that of commercial banks. Table 2 shows that today's GAAP solvent thrifts hold household financial assets representing more than 60% of their total assets. In sharp contrast, commercial banks hold only 23.9% of their total assets in the form of household financial assets.

TABLE 2: THRIFTS DIFFER GREATLY FROM COMMERCIAL BANKS

September 30, 1988

Asset Category	Thrifts (1)	Commercial Banks
Single-Family Loans (2)	37.7%	9.3%
Mortgage-Backed Securities	15.8%	2.8%
Multi-Family Loans (2)	5.6%	0.6%
Consumer Loans	4.4%	11.2%
Household Financial Assets	63.5%	23.9%
Non-Household Mortgage Loans	12.0%	10.3%
Business Loans	1.8%	15.6%
Foreign Loans	N.A.(3)	6.8%
Other Loans & Leases	0.1%	6.9%
Cash & Investments	13.2%	29.3%
Other Assets	9.4%	7.2%
Total Assets	100.0%	100.0%

(1) GAAP Solvent Only
(2) Permanent Loans Only
(3) Not Publicly Released
Source: Federal Home Loan Bank Board and Federal Deposit Insurance Corporation.

In sum, there is simply no basis for the oft-repeated assertion that thrifts have become "just like" commercial banks, and that there is, therefore, no justification for a separate thrift system.

I will not belabor the point further except to refer you to the statement submitted for this hearing record by Dr. Kenneth Rosen of the University of California at Berkeley. I think Dr. Rosen's discussion of the revolution in mortgage finance and the continued significance of the role played by thrifts in residential mortgage lending helps to clarify some of the misunderstandings that now exist in this regard. His comments on the Administration's plan and its impact on thrifts and housing finance, although not endorsed by the U.S. League, deserve your careful consideration.

The Administration's Proposal

Our business's hopes for quick resolution of the FSLIC crisis rose with the Administration's acknowledgment of the importance of our special role in residential finance and Secretary Brady's statement that:

> "The Administration's plan is designed explicitly to promote housing finance by revitalizing the S&L industry and the FHLBS."

Unfortunately, the legislation before this Congress -- the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (S.413) -- does not achieve the goal put forth by Secretary Brady. In fact, the Administration's proposal would cripple the Federal Home Loan Bank System and result in the liquidation of this nation's viable thrift institutions. The System would be sacrificed to pay for losses created by a handful of renegade operators the regulators failed to constrain.

Merging the FSLIC & FDIC

The FDIC's study of the issue of merging the federal deposit insurance funds (Deposit Insurance for the Nineties: Meeting the Challenge) argues strongly for a new independent FSLIC. The FDIC originally opposed a merger of these funds on any basis, administrative or otherwise. The GAO came to a similar conclusion in its recently released study of the FSLIC crisis and supported a new independent FSLIC.

After studying the issue, the U.S. League arrived at a similar conclusion and advocated a reconstituted, independent FSLIC. We advocated spinning off the FSLIC from the Federal Home Loan Bank Board because the experience of recent years suggests that the administrative benefits of having the Federal Home Loan Bank Board oversee the FSLIC were far outweighed by a lack of checks and balances in the thrift system. We supported an independent FSLIC as a separate entity to ensure that concerns for safety and soundness would always be the first priority. Such a balancing and independent force might well have mitigated the crisis we face today.

While this idea of preserving a separate thrift insurer seemed to have widespread support, President Bush changed the terms of the debate on February 6 by effectively merging the FSLIC and FDIC on an administrative basis thereby making the preservation of an independent FSLIC moot. By way of a special management agreement, the FSLIC delegated its case resolution and problem case management to the FDIC.

Having had a merger of the funds thrust upon us, we accept the inevitable and merely call for bringing this process to its logical conclusion -- a full merger of the funds. There is no supportable reason for an administrative merger alone, either from a public policy point of view or for restoring a viable operating environment for healthy savings institutions. In fact, there are powerful public policy reasons why an administrative merger alone is illogical and dangerous and why a full merger makes eminent sense.

In essence, an administrative merger is undesirable for five reasons:

- It will increase the cost to the taxpayer;
- It will foster budget gimmickry with monies not used or available to solve the problem counted, for budgetary purposes, against real taxpayer outlays;
- It will destabilize the already weakened thrift industry and could undermine the whole effort to resolve the FSLIC crisis;
- It will create an unfair competitive environment in the retail savings market; and
- It will create an extremely complex mechanism which could, instead, be replaced by a much simpler approach.

This cumbersome and extremely complicated mechanism would place today's healthy thrift institutions in a permanent "second class" insurance status, despite the fact we would be offering deposit insurance coverage identical to our competitors'. The built-in inequalities are evident S. 413's Sec. 208, which provides for separate insurance pool identifications instead of an identical FDIC insurance logo, separate assessment and rebate patterns, and separate FDIC authority to override maximum premium amounts. This does nothing but encourage our competitors to mislead our customers into believing one seal is superior to another. There is ample evidence of this practice in the current environment.

This situation not only is unfair to today's healthy thrift institutions, it is bad public policy and could be dangerously destabilizing. With the marketplace disruption from the abandoned "depositor's tax" of late January fresh in our memories, no one should doubt the skittishness of the depositor public.

The Administration's proposal would:

(1) Deny the FDIC emblem to thrift institutions with FSLIC ancestry, even though they are now fully subject to FDIC regulation, they are scheduled to pay higher premiums than their competitors, and they are obliged to meet common capital and accounting standards in a very short time frame.
(2) Invite continued efforts by competitors to mislead the public about the ultimate safety of insured deposits in thrifts, thus creating unnecessary fears among savers;
(3) Create a "second class" insurance status for thrift deposits thus increasing the cost of case resolutions for the Resolution Trust Corporation (RTC) and increasing the ultimate cost of resolving this problem for the taxpayer;
(4) Force thrifts to pay higher rates for deposits, which will reduce the industry's ability to compete and build capital internally;
(5) Institutionalize a significant competitive disadvantage for thrifts, thus making it more difficult to attract the new external capital the industry badly needs;

(6) Place specialized mortgage lenders at a cost disadvantage when competing for retail deposits thus allocating funds away from residential mortgage finance; and
(7) Require that increased commercial bank insurance premiums are credited to a Bank Insurance Fund pool to disguise the federal budget impact through offsetting collections, thus increasing the cost of resolving the situation to taxpayers.

This approach was endorsed last week at a meeting here in Washington of hundreds of commercial bankers who later fanned out across Capitol Hill to encourage its adoption by Congress. Before commitments are made, however, we would ask some hard questions.

Why, for example, would commercial bankers advocate an inferior approach in preference to a far better one which not only is less costly but, in fact, reduces the taxpayer expense?

Why do commercial bankers oppose using the same seal for both savings institutions and commercial banks in a post-merger environment when depositors in both types of institutions enjoy the same insurance protection? Is it possibly because they want to be able to imply that deposits in savings institutions are protected by an inferior brand of insurance? There already have been instances of commercial banks advertising that the federal insurance granted deposits in their institutions is superior to that provided savings institutions' depositors.

The effect of this will be the continued undermining of public confidence in savings institutions and in the financial system, in general, and the ongoing necessity for savings institutions to pay more for deposits than commercial banks.

Why do commercial bankers oppose commingling future insurance premiums from the two industries? How will they justify to the American people that the bill to be paid by the taxpayer will be much higher than need be?

The bankers act as if the fees they pay for insurance continues to belong to them. They want these premiums segregated into an essentially idle fund when they might be employed usefully today to help solve a pressing national problem and to cut down on the amount the taxpayer has to come up with. They make these demands at the same time the taxpayer is paying billions to the World Bank and the International Monetary Fund to insulate money center banks (and, by extension, the FDIC) from the consequences of uncollectible loans to third-world countries.

We face a monumental problem. We join in the desire of the Administration, the Congress and the American people to solve this problem for once and for all. We would ask the Congress to reject this expedient, artificial structure -- a structure that would prolong the problem.

If savings institutions have lost their independent insurer, if they are to be subject to the same rules as commercial banks, including accounting and capital rules, and if the insurance backing deposits in both types of institutions is not only backed by the identical full faith and credit of the U.S. government but also is provided by the exact same agency, then surely logic would dictate the full and complete merger of the funds.

For all these compelling reasons, the U.S. League of Savings Institutions asks the Congress for a complete merger of the funds. As part of such a full merger, the Congress should provide that:

(1) Thrifts and commercial banks be given identical FDIC insurance logos;
(2) By some date certain, thrifts and commercial banks pay the same federal deposit insurance premiums; and
(3) Future premiums from thrifts and commercial banks be commingled so that all such funds reduce taxpayer costs.

In seeking a full merger of the FDIC and FSLIC, the U.S. League seeks to commingle future premiums only. We recommend that the roughly $14 billion of accumulated bank premiums that now constitute the reserves of the FDIC be set aside into a special secondary reserve. This secondary reserve would absorb any commercial bank losses experienced over the next three years while the RTC absorbs thrift losses. Once the RTC's role is fulfilled, any remaining balance in the secondary reserve could be credited to institutions of FDIC ancestry to be paid out over time once the new FDIC fund balance reaches the targeted 1.25% of deposits ratio.

A full merger of the FDIC and FSLIC would greatly simplify this legislation. The two-pool arrangement would be eliminated, as would the need to separate old FSLIC obligations, and new SAIF and BIF obligations. Both the new REFCORP and FSLICREF could be eliminated by simply expanding the FICO authority and giving the debt service on those bonds first call on the premium stream of the new FDIC. Cash flows from old FSLIC asset recoveries and new SAIF asset recoveries would not have to be separated. In essence, a full merger would allow the funding needs of the FSLIC crisis to be met by an expansion of the already established FICO funding mechanism.

Full Merger Would Provide Added Revenues

One of the benefits of a full merger of the FDIC and FSLIC would be the ability to use all future premium payments of both thrifts and commercial banks to reduce the taxpayer burden of resolving the FSLIC crisis. Would it be fair to use commercial bank insurance premiums in this manner?

Healthy thrifts were not responsible for regional economic downturns, the faulty deregulation process of the early 1980s, the errors of the regulators or the abuses of renegade operators.

Indeed, healthy thrifts stood up and warned of the consequences of what was occurring. Yet our business has already paid an extra $4.5 billion in FSLIC premiums during the past four years toward these terrible losses.

Federal Reserve Board Chairman Alan Greenspan argued in his testimony before this Committee on February 23, that it is reasonable for the Treasury to pay some of the costs of resolving the FSLIC crisis. Chairman Greenspan said:

> "The reason for public expenditure to support deposit insurance is the basic benefits to the economy as a whole that we derive from deposit insurance. The certainty and stability provided by deposit insurance benefits the nation as a whole, while it protects the individual from catastrophic loss."

Still, no one wants the taxpayer to pay one dollar more than is absolutely necessary. In this regard, we cannot understand the Administration's decision to pursue a complex administrative merger and not utilize all future federal deposit insurance premium flows.

It is not as if the commercial banks and the FDIC have not already been the beneficiary of tax expenditures. As documented by Professors Jeffrey Sachs and Harry Huizinga of Harvard College, the money center banks have for the last several years, been bailed out of their foreign loan problems with billions of dollars from the government funneled to developing nations through the International Monetary Fund and and the World Bank. These countries then use the funds to pay interest owed to the large commercial U.S. creditor banks.

Commercial banks will be major beneficiaries of any plan to resolve the FSLIC crisis. Their deposit insurance system will be strengthened. Unfair pricing of deposit and loan rates by desperately insolvent thrifts will end, thereby lowering their cost of funds. And finally, they will attain their goal of being permitted to acquire healthy thrifts at bargain basement prices. Is it not then reasonable for commercial banks to give something in return for these benefits and to preserve the federal deposit insurance system?

It is important to recognize that the sums that could be garnered from commercial bank premium assessments are very significant. Table 3 shows that under the Administration's plan commercial banks will pay insurance premiums of $2.7 billion in 1990. Over the ten-year period 1989 to 1998, commercial bank premiums will total $41.3 billion. These funds will act as a federal budget offset but will not actually go to reduce the taxpayer's burden because the Administration's proposal does not commingle all FDIC insurance premiums.

TABLE 3: COMMERCIAL BANK PREMIUMS REPRESENT A SIGNIFICANT SOURCE OF FUNDS

(All dollars in Billions)

Year	Bank Premium Rate	Foreign Deposits	Domestic Deposits	Assessments On Average Domestic Deposits Under Treasury Plan
1989	0.08%	$328	$2,173	$1.8
1990	0.12%	$328	$2,323	$2.7
1991	0.15%	$328	$2,483	$3.6
1992	0.15%	$328	$2,654	$3.9
1993	0.15%	$328	$2,837	$4.1
1994	0.15%	$328	$3,033	$4.4
1995	0.15%	$328	$3,242	$4.7
1996	0.15%	$328	$3,406	$5.0
1997	0.15%	$328	$3,705	$5.4
1998	0.15%	$328	$3,961	$5.7
1989-94				$20.4
1995-98				$20.9
1989-98				$41.3

*Assumes 6.9% deposit growth

Further, the Administration did not propose that commercial banks pay premiums on their foreign deposits. This has been proposed by the Independent Bankers Association of America as a simple matter of insurance premium equity.

Some have argued that the additional revenues such premiums would garner are insignificant. Table 4 shows that applying the rates proposed in the Administration's plan, banks would pay roughly $400 million in premiums on their foreign deposits in 1990. This increases to nearly $500 million in 1991 and each year thereafter. Even assuming no growth in foreign deposits, this source would produce $4.6 billion in added revenues over the next 10 years.

TABLE 4: PREMIUMS ON FOREIGN DEPOSITS COULD PRODUCE SIGNIFICANT ADDITIONAL FUNDING

Year	Bank Premium Rate	Premium Revenue*
1989	0.08%	$274 Mil.
1990	0.12%	$394 Mil.
1991	0.15%	$493 Mil.
1992	0.15%	$493 Mil.
1993	0.15%	$493 Mil.
1994	0.15%	$493 Mil.
1989-1994		$2,637 Mil.
1989-1998		$4,608 Mil.

*Based upon foreign deposits of $328 billion as of September 30, 1989, and assumes no growth.
*Assumes 6.9% deposit growth

For that matter, a relatively small increase in commercial bank assessment rates for a period of five years could also produce substantial added revenues. For each one basis-point increase in the proposed commercial bank schedule of assessment rates on both foreign and domestic deposits the Treasury would benefit by roughly $265 million in 1990. If commercial bank premiums were set at the same rate as proposed for thrifts, this would produce an added $12.3 billion in federal reserves over the next five years.

Finally, unlike their thrift competitors, commercial banks can afford a significant premium increase. While the nation's healthy thrifts earned $3.5 billion in 1988, commercial banks had record earnings of almost $25 billion.

Liquidating Healthy Thrifts

The savings institution business has already paid an enormous sum to the FSLIC to help it resolve problem cases. Over the past four years, the business has paid $3.0 billion in regular premium assessments and $4.5 billion in special assessments for a total of $7.5 billion. This is a tremendous amount of money to an industry that desperately needs to build capital.

It is understandable that an angry Congress and public would seek to punish those responsible for the cost to society of the losses facing the FSLIC. Targeting healthy savings institutions, however, is a misdirection of that anger.

We have repeatedly pointed out that healthy savings institutions did not cause the problem facing the FSLIC. Healthy institutions have remained dedicated to home finance while the institutions that are causing serious losses to the FSLIC abandoned that role in the early 1980s. As mentioned earlier, just 25 institutions are responsible for half the losses facing the FSLIC. And most of these were institutions that were either started by or were allowed to be taken over by outsiders in the early 1980s.

Therefore, to put the healthy institutions at a permanent disadvantage to commercial banks is grossly inequitable. Even more important from a public policy point of view, it is shortsighted and counterproductive.

Given the trauma that they have been through since the early 1980s, a large portion of savings institutions need to increase their capital levels and the strongest institutions need to maintain their current levels. If savings institutions are required to permanently shoulder higher insurance costs than their commercial bank competitors, then the task of raising their capital levels through retained earnings becomes all the more difficult.

In addition, many institutions will not be able to reach adequate capital levels through retained earnings alone. They will need to raise additional amounts of equity in the capital markets, either through conversion to stock form for mutuals or through issuing additional shares if they are stock. However, if savings institutions are placed at a permanent disadvantage relative to commercial banks, investors will be reluctant to buy the needed shares. Why would anyone willingly put equity funds in savings institutions insured by the FSLIC or SAIF when the strongest institutions are straining at the bit to get out and cross over to the commercial bank insurance fund?

Finally, at a time when homeownership is becoming less and less affordable to the average person, it doesn't make sense to cripple the premier providers of home finance in the country. Even the craftors of the Basel Accords and the commercial bank regulators recognized the relative low risk of home lending by assigning a risk-weight to mortgages that is only half that of commercial loans. On these grounds and given the need for affordable housing finance, one could even argue that institutions dedicated primarily to home mortgage lending should pay a premium that is less than the commercial banks' assessment.

There is certainly no justification for continued higher premiums. This is particularly the case since the legislation before the Congress contemplates applying regulatory and capital standards to savings institutions that are at least as tough as those on commercial banks.

While savings institutions already are paying an insurance premium higher than commercial banks', the Administration's proposal would raise this level even higher and continue a differential. Table 5 compares the proposed federal deposit

insurance fees to be paid by a thrift and a commercial bank that each hold one billion dollars in deposits. On the same amount of deposits and for the identical federal guarantee, the thrift would have to pay $7.35 million more over the next 10 years. This added burden places such a thrift at a severe competitive disadvantage while making it more difficult for the institution to build and attract new capital. Further, commercial banks may achieve premium rebates far sooner than thrifts so that their assessment rate may be only 0.06% long before any reduction from the thrift 0.18% level is achieved. The premium disparity could be even worse than it is now.

TABLE 5: THRIFTS WILL PAY MUCH MORE FOR DEPOSIT INSURANCE THAN COMMERCIAL BANKS

Year	Thrift Assessment Rate	Thrift Premium	Commercial Bank Assessment Rate	Commercial Bank Premium
1989	0.208%	$2.08 Mil.	0.083%	$0.83 Mil.
1990	0.208%	$2.16 Mil.	0.120%	$1.24 Mil.
1991	0.230%	$2.55 Mil.	0.150%	$1.66 Mil.
1992	0.230%	$2.73 Mil.	0.150%	$1.78 Mil.
1993	0.230%	$2.92 Mil.	0.150%	$1.90 Mil.
1994	0.180%	$2.44 Mil	0.150%	$2.04 Mil.
1995	0.180%	$2.61 Mil.	0.150%	$2.18 Mil.
1996	0.180%	$2.80 Mil.	0.150%	$2.33 Mil.
1997	0.180%	$2.99 Mil.	0.150%	$2.49 Mil.
1998	0.180%	$3.20 Mil.	0.150%	$2.67 Mil.
TOTAL		$26.47 Mil.		$19.12 Mil

DIFFERENCE = $7.35 Mil.

*Assumes 7% deposit growth.

Yet the Administration proposes to go even further. The Administration's legislation includes a provision which allows the Chairman of the FDIC to increase the premium assessment rate by as much as 50% annually if the SAIF pool has a ratio of reserves to deposits of less than 1.2% or the FDIC forsees substantial future losses. The maximum assessment rate under these conditions is set at 35 basis points.

Under the plan, premium flows from institutions with FSLIC ancestry are committed as follows:

(1) First, to interest on outstanding and additional FICO bonds;
(2) Next, to a contribution to defease principal on the new REFCORP bonds;
(3) Then, to help purchase zero coupon bonds to defease funding for accumulated FSLIC notes and assistance agreements (FSLICREP);
(4) And finally, to build reserves in the new SAIF.

Certainly these successive claims raise serious questions as to whether the 20.8-, 23-, 18-basis-point levels set forth in S.413 can possibly meet the premium burdens.

Under this new provision and given the state of the FSLIC going into the program , the thrift assessment rate would reach 31.3 basis points in 1990 and the 35-basis-point maximum in 1991 and thereafter. Given the fact that the business must build capital and that solvent thrifts had an annualized after-tax return on assets (ROA) of only 31 basis points during the first nine months of 1988, we believe that this proposed assessment rate could result in eliminating the thrift industry. Even today's strongest thrifts would be sorely weakened by such an assessment rate.

The proposal also contains a further legislative provision which would allow the FDIC to exceed even the 35-basis-point maximum assessment rate if it is necessary to do so to pay actual losses. That is, the Administration proposes that the entire capital of every healthy thrift be subject to seizure to pay for losses incurred by the insurance fund.

It has been suggested that these additional assessment powers will never be used. In the past, similar assertions were made concerning the use of FSLIC's current power to assess special premiums, the ability of the Bank Board to do away with the secondary reserve, and a promise that FSLIC special assessments would be phased-out. In this regard, we note that the FSLIC special assessments have been in force for more than four years. We would further note that the CEBA's Secondary Reserve pay-back provisions would be eliminated by the Administration's proposal. Suffice it to say, that it is only prudent for us to assume that any power to assess premiums will be used in the future.

Crippling the Federal Home Loan Bank System

Whether the FSLIC and FDIC are fully merged or administratively merged, the new FDIC will be an independent force to promote safety and soundness, and thus the U.S. League supports its establishment.

The U.S. League also supports placing the new Resolution Trust Corporation (RTC) under the Treasury. This structure will provide the Treasury with direct oversight of taxpayer funds used to help resolve the FSLIC crisis.

Given these significant structural changes, we see no reason why the Federal Home Loan Bank Board, the 12 Federal Home Loan District Banks, and the Federal Home Loan Mortgage Corporation should become a "bureau" under the Treasury.

In his testimony on this subject, Secretary Brady stated that the Treasury did not intend to micro-manage the Federal Home Loan Bank System. He went on to give essentially three reasons for the need for Treasury oversight. First, he stated:

> "The reason is clear: Treasury funds are being used for the first time as part of the clean-up operation."

We do not see this as reason for Treasury oversight of the Bank Board and Bank System, since they will not be involved in the expenditure of funds in the "clean-up" operation. Rather, the RTC will be involved in the handling of Treasury funds, and thus it is the RTC that should come under Treasury oversight so as to ensure that Treasury funds are properly utilized.

Second, the Treasury Secretary argued:

> "Treasury oversight is essential to ensure that these problems and the strain they place on our financial system do not occur again."

We believe the presence of an independent insurer (the new FDIC) will ensure that the problems of the past are not repeated. Further, Bank Board supervision -- both in quality and quantity of staffing -- has been greatly improved during recent years and now stands in stark contrast to its predecessor apparatus.

Third, Treasury Secretary Brady stated:

> "Treasury oversight is essential to ensure a strong and safe system for readily available home financing."

This is clearly not part of the role of the U.S. Treasury. We know of no Administration or Congress which has looked to the Treasury to promote housing finance. To the contrary, the thrift system including the Federal Home Loan Bank Board, the Federal Home Loan Banks, and Freddie Mac have been specially designed to serve housing finance -- just as the Farm Credit System has been created and revised by Congress to preserve a stable source of credit for agriculture. In our view, they can best continue to fulfill this mission as independent entities.

For that matter, the idea that the Federal Home Loan Bank System should be placed in the same status as the Comptroller of the Currency can only derive from a lack of understanding of the role and operation of the Bank System. The Federal Home Loan Bank Board does have a chartering and supervisory function similar to that of the Comptroller of the Currency. This can continue even after an FSLIC and FDIC merger.

In addition, however, the Bank Board has an important role to play in housing finance. As supervisor of the regional Home Loan Banks, the Board ensures that the System supports thrifts as specialized mortgage lenders. Federal Home Loan Bank advances provide thrifts with a source of long-term funding which allows them to hold residential mortgages and mortgage-backed securities in portfolio.

Taking the all-consuming burden of the FSLIC off the shoulders of the Bank Board will enable it to focus undistracted on the prudent supervision of the healthy portion of the industry, its oversight of the Federal Home Loan Banks and its role as the directorate of Freddie Mac.

Indeed, in order to further the Federal Home Loan Bank System's role in housing finance, we would support extending membership access to other financial institutions that are by some test -- a qualified housing lender test, perhaps -- found to be committed to housing finance. Perhaps a graduated access proportional to the extent to which they provide permanent home finance would be possible (as enacted for thrifts now participating in the FHLBank System by Sec. 105 of the Competitive Equality Banking Act of 1987).

We believe placing the Federal Home Loan Bank Board, the 12 Federal Home Loan Banks, and Freddie Mac under the Treasury would de-emphasize their housing role. In a sense, the Federal Home Loan Bank System and Freddie Mac as entities given federal agency status are competitors of the Treasury as it raises funds. This could lead to policy decisions which limit the access of these two important housing agencies to the nation's capital markets.

Clearly, placing the FHLBS as a "bureau" in the Treasury gives that organization an impossible conflict of interests to resolve. It may want to limit the use by the FHLBS of consolidated obligations in the capital markets to reduce market pressures as it funds the deficit. It would have to weigh the impact of reduced FHLBS advances for housing at the same time. This would be a terrible conflict for the Treasury to resolve internally. Instead of de-emphasizing the role played by the Federal Home Loan Bank System in housing finance, we believe it should be enhanced. As has been suggested by Chairman Riegle, a name change which more effectively portrays the housing role of the System may be desirable. Rather than reduce the Bank Board to a Chairman only, an increase in the size of the Board to five members with staggered ten-year terms would also serve to enhance its effectiveness through continuity.

The Well-Being of the FHLBank System

Our concerns about the future of the Federal Home Loan Bank System go beyond the concept of placing it under the Treasury. We are also fearful about financial demand the Administration's proposal would place on the System.

At the end of 1988, the Federal Home Loan Bank System had assets totaling $174.6 billion, making it one of the largest financial organizations in the nation. Its GAAP capital-to-assets ratio was 8.88%, which means it is also one of the best capitalized financial entities in the U.S.

Most of the Bank System's capital, however, is in the form of stock held by member savings institutions which, as you know, include FDIC-insured savings and cooperative banks, as well as FSLIC-insured thrifts. All members of the Bank System must own stock proportional to the amount of home mortgages they hold in portfolio or to the amount of borrowings from the Home Loan Banks. The capital stock of the Bank System totaled $13.2 billion at the end of 1988.

Because the stock of the FHLB System is held by member thrifts, every effort is made to ensure that the System does not incur a loss. Borrowers must not only buy Bank System stock but also collateralize their borrowings. Until recently, only high quality collateral was acceptable for this purpose.

If stockholder members are not going to incur a loss, the only capital available to the Bank System to cover losses is its retained earnings of $2.3 billion (total capital of $15.5 billion minus capital stock of $13.2 billion) which is what the Bank System has left after committing $500 million to date to the FICO bonding program. There is a further commitment of the Bank System to future FICO bonding which would reduce the System's retained earnings by roughly another $500 million. This leaves the entire Federal Home Loan Bank System with roughly $1.8 billion of reserves to cover any future losses if the value of member stock is going to be protected.

The Administration's proposal would commit to the FSLIC shortfall all of this $1.8 billion remaining to the Federal Home Loan Bank System. In addition, it would take $300 million of the System's future earnings each year until all the bonds issued by the REFCO funding operation were paid off. Obviously, this action would seriously weaken the capacity of the Bank System to cover losses and expose member stock -- and thus member thrift institutions -- to potential losses.

In our view, there is no justification for crippling the

Federal Home Loan Bank System by draining its reserves and confiscating its future earnings to deal with the FSLIC crisis. Clearly, it makes no more sense to take resources from the Federal Home Loan Bank System for this purpose than it does to draw on the other federal agencies which support housing finance. It is not good public policy for the nation to seriously weaken its housing support agencies in an effort to find additional funds to resolve the FSLIC crisis.

It is true that under the CEBA legislation, the Congress mandated that FHLB System retained earnings could be used for $10.8 billion in FICO bonding. Although the total retained earnings of the system were frequently referred to, it was clear in the financial calculations that the burden would be only a limited portion of those earnings. Further, no future Bank System earnings were committed so that the System could use these to rebuild its retained earnings base.

The simple fact is that all the funds that could be safely and prudently removed from the Bank System have been committed to the FICO bonding. Given the already heavy demands on the thrift industry and its desperate need to build and attract new capital, it would be imprudent to expose healthy companies to losses on their stock holdings as members of the FHLB System.

It should also be recognized that the Administration proposal would also have the effect of reducing the earning assets of the FHLB System. This would reduce future System earnings and member dividends.

In 1988, the FHLB System earned $1.47 billion for a return on assets of 84 basis points. The System paid member stockholders $1.23 billion in dividends. Earnings under the Administration's proposal would be reduced by $300 million directly and by roughly another $200 million indirectly as a result of the forgone earnings. This amounts to a reduction by about one-third of FHLB System earnings.

Of course, FHLB System dividends paid-out could be reduced by more than this reduction in earnings. Given that there is a legal reserve requirement that 20% of FHLBS earnings be held in a special reserve, member's dividends will be 50% of their old level at best and could disappear altogether in some Bank Districts. In order to be prudent, the FHLBanks could reduce their dividend payments by 50% or more in an effort to rebuild their retained earnings base.

Reduced FHLB System dividends -- which affect both FDIC and FSLIC thrifts -- would lower thrift member income and add to the burden of the Administration's proposal on the business. It would also make FHLB advances relatively more expensive (members must buy additional stock as they use more advances). This would reduce the use of FHLB advances and probably further lower Bank System earnings and dividends.

In our view, the FHLB System was established to support thrifts in their role as residential mortgage lenders. It would be a tragic error to undermine this function. Combined with the proposal to place the Federal Home Loan Bank System under the Treasury, draining these funds as proposed would seriously cripple the Bank System.

The Administration's proposal also would allow the FDIC to borrow from the FHLBS for the new SAIF pool. Further, the composition of the regional Federal Home Loan Bank Boards of Directors would be altered. Instead of being comprised to a large extent of FHLBS member institutions, the regional Federal Reserve Bank structure would be imposed as a model. As a result, thrift institution representatives -- the sector with the largest financial stake in the FHLBS's operation -- would become a minority on the regional Federal Home Loan Bank Boards.

The argument for changing the regional Bank's Board composition is based on false fear of conflicts of interest. This is despite the fact that these Boards always have been strictly prohibited from discussing supervisory matters. Further, under the Administration proposal the District Bank presidents would no longer perform a supervisory role. This of itself should ease the baseless fear of conflict of interest. We would remind that the District Banks are owned by their members. Thus, members should have the majority voice in their Boards of Directors.

This leads to a fundamental issue concerning the regional Federal Home Loan Banks that does not appear to be recognized. The simple fact is that the paid-in capital of the Bank System held by the nation's thrifts creates a huge loss exposure for member institutions. Regional Federal Home Loan Bank stock represents roughly one-fifth of the thrift industry's total GAAP capital and one-third of its tangible GAAP.

If the FHLBS is going to be used as a funding source for the FSLIC crisis (its retained earnings taken and future earnings garnisheed) and if member institutions are no larger going to be able to protect the safety of the FHLB stock holdings as members of the regional Bank Board's of Directors, then the stock requirements for members should be changed to equate to those of regional Federal Reserve Banks.

Members of the Federal Reserve Banks are required to hold Reserve Bank stock equal to 3% of their own institution's capital. Another identical amount (3% of capital) is available for call by the Reserve Bank if needed.

Applying these requirements to the regional Federal Home Loan Banks would significantly reduce member institution stock holdings and, thus, member exposure to loss. The process involved in this exchange would be simple. Member institutions would simply cash in their excess stock as can be done currently. Of course, reducing FHLB System stock requirements to those of the Federal Reserve System would leave substantially more excess stock available for exchange.

The reduced level of paid-in capital could impact future consolidated obligation costs, the costs of advances, and future FHLBS earnings. The impact would be moderated by the agency status of the FHLBS. Still, the Bank System would be weakened to the detriment of housing.

In sum, the U.S. League believes that the Administration's approach to the Federal Home Loan Bank System is dangerous and could destroy the System. We would prefer that the Bank System be left out of the funding for the FSLIC crisis. If this is deemed impossible by the Congress, then we ask that the stockholding requirements for the Federal Home Loan Banks be identical to those of regional Federal Reserve Banks.

Rebuilding the Thrift Industry's Capital

As noted earlier, our business recognizes that it must rebuild its capital base. We agree with Treasury Secretary Brady, who said:

> "We have learned a valuable lesson: Deposit insurance simply will not work without sufficient private capital at risk and up front."

We would add to this statement, however, that management must be given a realistic time-frame within which to accumulate capital. It is also essential that whatever standards and definitions are set in place remain constant for a substantial period into the future. Nothing is more discouraging than to work hard to meet an established goal and then repeatedly see the goal moved further away.

At present, the Federal Reserve Board of Governors and the Comptroller of the Currency have issued risk-based capital requirements. The FDIC has not done so although we understand final rules will be issued by that agency in the near future.

S. 413 asserts that the capital rules for thrifts should be no less stringent than those for national banks. This means that thrifts would have to look to the capital rules of the Comptroller of the Currency (OCC) for their minimum future capital requirements.

This is not an easy task. As part of its new risk-based capital guidelines, the Comptroller notes that, "In the near future, the OCC intends to propose amendments to its current leverage ratios...." The OCC's guidelines go on to state that these new amendments will involve a new capital definition and provide a minimum level of capital below which no bank can operate without a plan to restore capital. In this regard, the guidelines note, "However, it is anticipated that this new minimum leverage ratio will be lower than the current standard."

All of this has created great uncertainty and confusion in the thrift industry. In essence, this proposed legislation would require thrifts to meet some undefined capital standard by June 1991. Further, it would allow both the new FDIC and the new FHLBS to define even more stringent requirements if they so desired.

In this regard, it is important to recognize that the thrift industry has seen its capital position badly eroded by deregulation and its aftermath. Table 6 shows the GAAP capital position of the thrift industry as of September 30, 1988.

TABLE 6: THE THRIFT INDUSTRY MUST REBUILD ITS CAPITAL BASE*

GAAP Capital As a % of Assets	Number of Institutions	Assets of Institutions (Billions of $)
Less than 0%	436	$ 142.4
0% to 3%	399	$ 277.4
3% to 6%	966	$ 621.0
More than 6%	1,223	$ 282.6
Total	3,024	$1,323.4

*Data as of September 30, 1988
Source: Federal Home Loan Bank Board

As the Table indicates, the thrift industry has an enormous task before it in trying to rebuild its capital base. Although we fully recognize the need for and support a move to higher capital standards for thrifts, we also believe it must be done in an orderly manner. Establishing an unrealistic timetable would be counterproductive and produce added losses for the deposit insurance system. It could also go a long way toward destroying the retail savings-based thrift sector and the significant role it plays in housing finance.

In this regard, we would refer the Committee to a recently released study of this situation done by Shearson Lehman Hutton. This is so important that I believe the following extensive quotation is warranted:

> "Rebuilding the capital strength of the savings and loan industry will present a considerable challenge. Shearson Lehman estimates that the industry would need to raise between approximately $20-35 billion in capital (assuming goodwill would not be grandfathered) by June 1, 1991, to the meet the new capital requirements envisioned in the Administration's

proposal. In the past two years -- approximately the same period of time currently envisioned for the transition to the new capital requirements -- the industry raised only $4.2 billion in new capital. Most of this, $2.9 billion, was in the form of capital raised in conversion of institutions from mutual to stock form, one-time transactions that few new institutions are likely to undertake in today's market environment. During the entire period between 1980-88, the industry raised only $20 billion in capital, of which approximately $13 billion was in the form of conversion offerings. This suggests that even if though the Administration proposes permitting the industry to amortize goodwill over as long as a ten-year period, the industry will face extreme difficulties in meeting the capital requirements. Therefore, regardless how it is structured, the Administration's proposal envisions that the industry would raise an amount of capital that is entirely unprecedented in its recent experience."

Shearson is not the only Wall Street firm to come to this conclusion. First Boston also commented on the Administration's plan in a February 15 newsletter. Referring to the proposed mid-1991 date for new capital requirements, First Boston stated:

> "Truly forcing savings institutions to meet commercial bank capital requirements by 1991 would have a devastating impact on the current thrift industry, i.e., it would virtually eliminate it."

Peter Treadway of Smith Barney sounded a similar note in his testimony before this Committee on March 3 when he stated:

> "My estimate would be that within five years 2/3 to 4/5 of the 3,000 or so FSLIC savings and loans operating today will have been liquidated, merged or voluntarily closed down."

Again, I will not belabor this point. I have attached to my testimony, however, a statement by Jonathan E. Gray, Senior Research Analyst of Sanford C. Bernstein & Co. I think Mr. Gray's analysis of the impact of deregulation and the thrift industry's current condition helps to clarify the enormity of the situation facing our business. I believe his analysis, although not endorsed by the U.S. League, deserves your careful consideration.

Mr. Chairman, we do not believe that the liquidation of the thrift industry is warranted or desirable. A reasonable transition to higher capital levels is a much better approach for today's viable thrifts, for housing finance and for the nation.

Further, we must take strong exception to the idea that goodwill which has been added to the books of many thrifts and is fully valid under GAAP accounting should no longer count as capital for our institutions. The overwhelming majority of

this goodwill was acquired by thrifts as they acquired weak or troubled institutions in supervisory-related mergers. Both the OCC and the Federal Reserve Board (for State member banks) grandfather such supervisory goodwill. We believe the goodwill now held by thrifts should be grandfathered and allowed to amortize under the GAAP accounting rules that permitted it.

Mr. Chairman, capital standards are a life and death issue to a Federally insured financial institution. As such, we believe that it is essential that a stable set of definitions and standards be established.

The U.S. League strongly supports applying the same risk-based capital rules to all financial institutions after an appropriate transition period and with reasonable grandfathering provisions. These capital guidelines should be the same as those of national banks -- no more and no less stringent. Because this is a vital issue and in light of the need for a viable transition process coupled with reasonable grandfathering, we would ask the Congress to put some selected capital provisions, transition rules and grandfathering specifications in law.

First, the Basel Accords agreed upon in 1987 by central bankers from 11 industrialized nations, including the United States, recognized that residential home loans are low-risk assets. Although banking regulators in this country and in the various countries around the world represented on the Cooke Committee debated the issue, today's final risk-based capital rules establish residential mortgages as having a 50% risk weight relative to commercial loans. We believe this is appropriate.

Second, goodwill is an acceptable asset under GAAP accounting. Most of the goodwill in thrift institutions today is the result of past supervisory-related mergers. In some cases, the FSLIC-arranged merger carried no hard dollar assistance with it. We believe all existing goodwill should be grandfathered under the GAAP rules by which it was created.

Third, many thrifts reached contractual agreements with the FSLIC regarding their individual capital requirements and related business plans. We believe that these agreements were entered into on a good-faith basis and should be grandfathered when the FDIC and FSLIC are merged.

Fourth, it is essential that thrifts be given a reasonable transition period to rebuild capital. The guidelines of the Federal Reserve Board and the Comptroller of the Currency provide an interim target of December 31, 1990, and a final date of December 31, 1992. We believe that the interim target should be extended to December 31, 1992, for thrifts and the final target to December 31, 1995.

Fifth, the CEBA legislation provided for a phase-out of deferred loan losses and a target date for thrifts to be placed on a full GAAP basis. We believe these schedules should be maintained.

In sum, the U.S. League fully endorses equal risk-based capital requirements for commercial banks and thrifts, provided that a reasonable period for transition to these equal standards is permitted.

Preserving Our Nation's Housing Delivery System

We urge Congress to examine the Administration's proposal closely, for we fear that great dangers lie within it. Specifically:

By placing the Federal Home Loan Bank System under the Treasury, a vital source of capital to housing finance will be endangered. Currently, the FHLB System raises funds in the capital markets and makes advances to savings institutions, which use them in turn to make residential mortgage loans. Under the Treasury, however, the FHLB System's access to the capital markets would be reduced, should the Treasury seek to reduce a source of competition for its own financings. The result would be higher mortgage rates and less affordable housing.

By eliminating the Federal Home Loan Bank Board and radically changing the role of the FHLB System, the structure which has supported specialized housing lenders will no longer exist Housing will have to compete for capital with corporations and other major credit users. Mortgage rates will increase, and, again, housing affordability will suffer.

Heavy premiums for insured deposits will reduce the ability of depositories to build capital. Meager profits in turn will make it more difficult to attract new, outside capital. The inability to build higher capital levels will make it impossible for depositories to hold mortgages to the extent they would have under other circumstances. As a result, less mortgage money will be available and housing will be denied to millions of households.

Finally, the existence of a larger premium on thrift institutions as compared with their commercial banking competitors will make it difficult for these institutions to compete for insured deposits. To the degree that these funds are used for mortgage finance, this competitive disadvantage will mean less money available for homebuyers. Mortgage rates will increase.

Conclusion

Before concluding, Mr. Chairman, I would make a final plea for justice -- justice for the prudent among us, as well as justice for the highrollers and the crooks.

I am confident that you would be the first to admit that justice is not served when managers of healthy institutions are smeared with the same tar that rightly should cover the criminals as they are run out of town.

Neither is justice served when the public is led to believe that my institution or any other is somehow going to be "bailed out" at taxpayer expense.

Nor is justice served when customers we have known for years are traumatized to the point of needlessly withdrawing funds from institutions bearing the FSLIC seal.

We the honest and prudent have paid a heavy price, Mr. Chairman. We are weary of being unjustly vilified and of seeing our contribution to the growth of hometown America come subject to sneers.

None has been stung harder by this crisis than the thousands of responsible savings institution managers who strive daily to deliver affordable mortgage credit and make home ownership a realizable dream. We have paid dearly for the sins of others, and we are still paying.

Meanwhile, we the healthy continue to hold nearly two-thirds of our assets in housing-related, family-related loans. We continue our commitment to housing America.

We want to continue that type of lending as our speciality, because that is what we do best. Do away with our institutions today, and you will have to re-invent us tomorrow if affordable housing credit is to be available in this country.

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* The U.S. League of Savings Institutions serves the 3,000 member-institutions which make up the $1.2 trillion savings association and savings bank businesses. League membership includes all types of institutions -- Federal and State-chartered, stock and mutual. The principal officers include: Barney R. Beeksma, Chairman, Oak Harbor, Washington; Kenneth Seaton, Vice Chairman, Hancock, Michigan; Frederick L. Webber, President, Washington, D.C.; Denis O'Toole, Executive Vice President, Government Affairs/Operations, Washington, D.C.; and Philip Gasteyer, Executive Vice President, Policy and Plans, Washington, D.C. League headquarters are located at 1709 New York Avenue NW. Washington, D.C. 20006. Telephone: (202) 637-8900.

The Thrift Industry: Anatomy of Failures -- Formulas for Success

Testimony of Professor Kenneth T. Rosen
Center for Real Estate & Urban Economics
University of California at Berkeley

before the Senate Banking Committee
March 7, 1989

Mr. Chairman and Members of the Committee:

Summary

- The financial crisis faced by the FSLIC is an insurance crisis caused by a small minority of mismanaged or fraudulently run thrift institutions and bungled regulation and not an industrywide crisis -- These institutions should be closed and fraudulent players should be prosecuted to the fullest extent possible. Political leaders, consultants, and lawyers who intervened on their behalf should also be prosecuted.

- 70% of thrift institutions are healthy and prudently managed and have the vast majority of their money invested in residential mortgage loans -- These institutions should be allowed to remain specialized residential mortgage lenders, regulated by an independent but revamped Federal Housing Bank System. They should have continued access to long term advances, and favorable capital requirements as long as they remain invested exclusively in residential mortgages. Placing the FHLBS under the Treasury would deal a potential death blow to housing. Treasury has a built-in in institutional bias against the allocation of funds to housing and only an independent agency can serve that function. Also, since the safety and soundness issue will be removed from the FHLBS and transferred to FDIC, the conflicts of interest of the past decade will be removed from the regulatory system.

- 85% of the losses incurred or likely to be incurred by the FSLIC are due to direct real estate investment (often disguised as loans), land development activity, commercial real estate activity and other inherently risky ventures -- Direct investments by financial institutions of government insured deposit funds should be prohibited.

- 55% of the FSLIC losses have occurred in the energy belt states of Texas, Louisiana and Colorado -- while the insolvent financial institutions must be closed, the economies of these areas are likely to show substantial recovery in the next five years. A slow liquidation and intensive management of real estate assets might substantially reduce the actual losses to the government.

- At least 50% of the FSLIC losses occurred because of the rapid growth of new entrants into the industry who were inexperienced, incompetent, and/or unscrupulous -- The ability to open a financial institution with government deposit insurance should be substantially restricted to those with lending and management experience, substantial real capital (at least $50 million) and a broad based ownership structure (to prevent self-dealing). Asset growth should also be restricted, loan diversification required, and conflicts of interest closely monitored. The use of brokered funds to support asset growth should be severely restricted.

- The savings and loan industry is still vital to the home mortgage industry -- 50% of home mortgage originations in 1988 were made by thrifts and 42% of home mortgages including mortgage securities were held by thrifts.
- Advances of the Federal Home Loan Bank System to the thrifts have been vital in supporting home mortgage lending -- The administration's proposal to tap the capital of the FHLBS to support the FSLIC bailout is short-sighted, as it could cripple the advance creating ability of the FHLBS. It is equivalent of a hidden tax on the healthy thrifts of another 8-10 basis points.
- The proposed differential deposit insurance premiums for healthy savings and loans relative to commercial banks continues and exacerbates the competitive disadvantage for healthy thrifts. While it may give the appearance of parity, because of the rebate of fund surpluses, the FDIC-insured institutions will likely have a 10 basis point advantage by the mid-1990s.
- The profit margins in the lending industry are already narrow, with the total insurance premium equal to 40-50% of the healthy industries profits and the new proposed differential equals 16% of the healthy industries profits. Also, the uncapped premium proposal (or even a cap at 35 basis points) would make it impossible to attract new capital to the industry. The regulatory risk of premium increase would be equivalent to capital confiscation.

- FSLIC (and FDIC) insurance should be converted from a deposit guarantee fund to a true insurance program, with differential pricing based on the riskiness of an institutions assets. Risk pricing elements should asset class (i.e., credit risk), geographic location of assets, and interest rate sensitivity.

The present rush to "solve" the thrift problem by the current administration is like its predecessor's reform, the Garn-St. Germain legislation in 1982, a recipe for disaster. The thrift crisis of 1988-89 and the consequent need for a $100 billion rescue package, is a direct consequence of the 1982 thrift reform legislation. This early reform of the thrift industry combined with bungled and inept regulation, misguided congressional intervention on behalf of failing thrifts, mismanagement and fraud, stupidity in both the public and private sectors, and a regional depression in the energy belt, has brought us the biggest financial scandal in American History.

The proposal by the administration, while a move in the right direction, if not modified in several ways, could ultimately destroy the healthy segment of the savings and loan industry to pay for the past ineptitude of the federal regulators and in many cases criminal activities of a minority in the business. Besides the obvious injustice, the consequences of this proposal could be to create a scarcity of private sector home mortgage credit and even more reliance on federal government agencies to provide this credit. The cost to government of weakening the healthy sector of the thrift industry may be an additional $100 billion per year of off budget mortgage security guarantees. To the consumer, the lack of a viable thrift industry will mean higher mortgage interest rates, lower interest rates on savings deposits, and less choice of mortgage instruments and less availability of mortgage credit.

This bleak prognosis, however, need not occur. A carefully crafted plan can freeze the massive losses from the savings and loan crisis and perhaps recover half the losses estimated by the

administration. A revised regulatory structure could prevent future abuses of the federal deposit insurance system and refocuses the surviving healthy thrifts on safe and sound lending to the residential mortgage market.

I would now like to present my views on the causes and magnitude of the thrift crisis and the importance of the thrift industry to the residential housing market.

I. Causes of the Thrift Crisis

There are three major and interrelated causes of thrift crisis. The deregulation of thrifts asset and liability structure in the 1982 Garn-St. Germain set the stage for the activities that would create the crisis. This highly unregulated environment, combined with virtually free government deposit insurance provided by the FSLIC attracted a large number of new participants into the industry. These players saw that they could attract large sums of government insured capital and invest this money virtually without restriction in a variety of investments which most traditionally run financial institutions would regard as highly speculative. Overlaid against this free-wheeling regulatory environment was a real estate boom in the energy producing and sun belt states that sucked up large sums of capital even though the economic fundamentals of many of these markets had begun to dramatically weaken by early 1983.*

This deadly combination of: deregulation without adequate supervision, new-inexperienced, often unscrupulous and usually incompetent, entrants to the industry, and a regional real estate boom about to become mired in a regional economic depression, caused the present crisis. The crisis was exacerbated by the failure of Congress and the administration to provide adequate personnel and financial resources to the regulators who had recognized the growing problems by 1984. In addition, Congress specifically lobbied against proposed actions to deal with problems, such as brokered funds, land development loans, and the Texas institutions.

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*This author in a widely quoted speech in February 1983 correctly forecasted the collapse of the Texas, Oklahoma and Louisiana economies.

The detail documenting of these causal factors would take far more time then available here. The following charts, however, are strongly supportive of our view. Table I shows the best estimates of the capital situation in the industry as of Sept. 30, 1988. As can be seen clearly, we have a bi-modal distribution with 835 institutions reported GAAP capital of less than 3% showing a $23 billion deficit in tangible capital. Actual loss experience when these institutions are closed will probably be $50 billion given previous loss rates. On the other hand, over 1,200 institutions have over 6% GAAP capital and nearly $20 billion of tangible capital. Table II shows the concentration of loss estimates by state. Clearly, the Texas-Louisiana-Colorado axis is responsible for over 55% of losses. Table III illustrates the extent of the regional economic depression that in part created these losses. The cities in Texas Oklahoma, Colorado, and Louisiana are at the bottom of the list. Table IV shows that the losses were primarily due to the acquisitions of risky and non-prudent asset

TABLE I

GAAP CAPITAL TO TOTAL ASSETS RATIO -- ALL FSLIC-INSURED SAVINGS INSTITUTIONS

GAAP CAPITAL TO ASSETS	NUMBER	ASSETS	RAP CAPITAL	GAAP CAPITAL	TANGIBLE CAPITAL	LIAB.
< 0%	436	$142,425	($14,884)	($18,095)	($22,122)	$157,309
0% TO 1%	99	$96,812	$1,514	$606	($314)	$95,298
1% TO 2%	116	$63,314	$1,704	$1,029	($511)	$61,610
2% TO 3%	184	$117,272	$4,003	$2,907	($41)	$113,269
3% TO 4%	284	$167,469	$7,023	$5,833	$2,881	$160,446
4% TO 5%	337	$257,819	$13,254	$11,672	$6,841	$244,565
5% TO 6%	345	$195,748	$11,475	$10,738	$6,936	$184,273
OVER 6%	1,223	$282,558	$26,150	$24,762	$19,731	$256,408
TOTAL	3,024	$1,323,418	$50,230	$30,451	$13,400	$1,273,177

GAAP CAPITAL TO ASSETS	PERCENT OF NO.	PERCENT OF ASSETS	RATIO TO TOTAL ASSETS			PERCENT OF LIAB.
			RAP CAPITAL	GAAP CAPITAL	TANGIBLE CAPITAL	
< 0%	14.4%	10.8%	-10.45%	-12.71%	-15.53%	12.4%
0% TO 1%	3.3%	7.3%	1.56%	0.63%	-0.32%	7.5%
1% TO 2%	3.8%	4.8%	2.69%	1.62%	-0.81%	4.8%
2% TO 3%	6.1%	8.9%	3.41%	2.48%	-0.04%	8.9%
3% TO 4%	9.4%	12.7%	4.19%	3.48%	1.72%	12.6%
4% TO 5%	11.1%	19.5%	5.14%	4.53%	2.65%	19.2%
5% TO 6%	11.4%	14.8%	5.86%	5.49%	3.54%	14.5%
OVER 6%	40.4%	21.4%	9.25%	8.76%	6.98%	20.1%
TOTAL	100.0%	100.0%	3.80%	2.98%	1.01%	100.0%

Data as of September 30, 1988; Dollars in millions

Source: Federal Home Loan Bank Board

TABLE II
GAAP INSOLVENT SAVINGS INSTITUTIONS BY STATE

	TOTAL INSOLVENT			
	COUNT	GAAP CAPITAL	ASSETS	CAPITAL/ ASSETS
ALABAMA	5	($102)	$1,516	-6.73%
ALASKA	2	($89)	$310	-28.86%
ARIZONA	2	($357)	$800	-44.66%
ARKANSAS	13	($761)	$3,981	-19.12%
CALIFORNIA	25	($1,972)	$5,853	-33.69%
COLORADO	11	($436)	$6,356	-6.86%
CONN.	1	($20)	$143	-14.05%
DELAWARE	0	$0	$0	NA
WASH. DC	0	$0	$0	NA
FLORIDA	21	($881)	$7,185	-12.27%
GEORGIA	7	($32)	$930	-3.40%
GUAM	0	$0	$0	NA
HAWAII	0	$0	$0	NA
IDAHO	0	$0	$0	NA
ILLINOIS	46	($697)	$11,187	-6.23%
INDIANA	6	($34)	$887	-3.87%
IOWA	5	($108)	$770	-14.01%
KANSAS	16	($184)	$2,755	-6.67%
KENTUCKY	1	($23)	$51	-44.46%
LOUISIANA	30	($660)	$4,101	-16.10%
MAINE	0	$0	$0	NA
MARYLAND	5	($193)	$2,339	-8.24%
MASS.	0	$0	$0	NA
MICHIGAN	5	($139)	$1,385	-10.05%
MINNESOTA	3	($71)	$3,602	-1.96%
MISS.	9	($107)	$1,188	-9.01%
MISSOURI	11	($241)	$6,503	-3.70%
MONTANA	1	($10)	$135	-7.35%
NEBRASKA	9	($176)	$1,849	-9.51%
NEVADA	0	$0	$0	NA
NEW HAMP.	0	$0	$0	NA
NEW JERSEY	11	($193)	$3,450	-5.60%
NEW MEXICO	5	($627)	$1,563	-40.11%
NEW YORK	5	($70)	$2,290	-3.07%
NOR. CAR.	7	($24)	$2,175	-1.09%
NOR. DAK.	2	($8)	$205	-4.10%
OHIO	17	($296)	$5,927	-4.99%
OKLAHOMA	6	($29)	$1,541	-1.91%
OREGON	3	($156)	$881	-17.67%
PENN.	5	($75)	$3,200	-2.35%
P.R.	0	$0	$0	NA
R.I.	0	$0	$0	NA
SOU. CAR.	2	($28)	$1,071	-2.59%
SOU. DAK.	2	($6)	$138	-4.50%
TENNESSEE	5	($29)	$446	-6.54%
TEXAS	115	($8,837)	$49,154	-17.98%
UTAH	3	($115)	$2,657	-4.31%
VERMONT	0	$0	$0	NA
VIRGINIA	6	($133)	$2,098	-6.35%
VIRGIN IS.	0	$0	$0	NA
WASHINGTON	3	($25)	[illegible]	-3.55%
WEST VIRG.	0	$0	$0	NA
WISCONSIN	2	($35)	$310	-11.24%
WYOMING	3	($109)	$794	-13.67%
NATIONWIDE	436	($18,089)	$142,425	-12.70%

Data as of September 30, 1988; Dollars in millions   Source: Federal Home Loan Bank Board

TABLE III

EMPLOYMENT GROWTH AND UNEMPLOYMENT RATES BY CITY

	Nonagricultural Employment						Unemployment Rate					
	---1988---		---1987---		---1986---		---1988---		---1987---		---1986---	
MSA	Rank	Pct	Rank	Pct	Rank	Pct	Rank	Pct	Rank	Pct	Rank	Pct
Orlando, FL	1	7.5	4	6.9	7	5.2	67	4.7	57	4.6	51	4.5
Wichita, KS	2	7.4	25	4.0	40	2.6	45	5.7	52	5.0	46	4.8
Riverside-San Bernardino, CA	3	7.0	3	7.6	4	5.4	35	6.4	35	5.7	21	5.8
Las Vegas, NV	4	6.3	1	8.2	2	6.5	37	6.3	21	6.5	24	5.7
West Palm Beach-Boca Raton-Delray Beach, FL	5	6.2	2	7.9	1	6.5	41	5.9	61	5.3	44	4.9
Charlotte-Gastonia-Rock Hill, NC-SC	6	5.4	5	5.8	13	4.1	65	4.7	72	3.7	78	3.1
Sacramento, CA	7	5.2	6	5.5	6	5.2	38	6.2	38	5.5	30	5.3
Nashville, TN	8	5.1	39	3.2	87	-1.9	64	4.9	58	4.4	53	4.5
Seattle, WA	9	4.8	14	4.5	3	5.6	33	6.5	28	6.0	40	5.0
Atlanta, GA	10	4.8	36	3.3	72	1.5	68	4.6	55	4.6	33	5.1
Phoenix, AZ	11	4.8	34	3.4	65	1.8	49	5.6	47	5.2	35	5.1
San Diego, CA	12	4.6	7	5.3	8	4.9	63	5.0	59	4.5	57	4.3
Columbus, OH	13	4.5	19	4.3	19	3.6	40	6.1	40	5.4	43	4.9
Jacksonville, FL	14	4.3	8	5.2	5	5.3	50	5.4	62	5.3	31	5.2
Monmouth-Ocean, NJ	15	4.2	10	4.8	18	3.7	78	4.1	79	3.3	71	3.4
Indianapolis, IN	16	4.2	23	4.1	11	4.3	58	5.1	48	5.1	52	4.5
Washington, DC-MD-VA	17	4.1	16	4.4	20	3.5	84	3.4	83	3.1	82	2.9
Anaheim-Santa Ana, CA	18	4.1	17	4.4	36	2.7	80	4.0	81	3.2	79	3.1
Raleigh-Durham, NC	19	4.1	31	3.5	34	2.8	86	3.3	84	3.0	87	2.5
Norfolk-Virginia Beach-Newport News, VA	20	4.1	28	3.8	24	3.3	55	5.2	54	4.7	54	4.4
Tampa-St. Petersburg-Clearwater, FL	21	3.9	12	4.7	29	3.0	59	5.1	53	4.8	49	4.6
Hartford, CT	22	3.9	35	3.4	35	2.8	85	3.4	85	3.0	83	2.8
Grand Rapids, MI	23	3.8	44	2.9	22	3.5	16	7.4	26	6.2	27	5.6
Fort Lauderdale-Hollywood-Pompano Beach, FL	24	3.8	9	5.1	9	4.6	72	4.4	66	4.2	58	4.1
Memphis, TN-AR-MS	25	3.7	13	4.5	32	2.8	25	6.8	34	5.7	37	5.0
Cincinnati, OH-KY-IN	26	3.6	24	4.0	25	3.3	34	6.5	30	5.9	34	5.1
Greenville-Spartanburg, SC	27	3.6	26	3.9	31	3.0	60	5.1	62	4.4	67	3.6
Columbia, SC	28	3.5	15	4.5	23	3.3	83	3.7	69	3.8	73	3.3
Richmond-Petersburg, VA	29	3.5	11	4.7	14	5.9	75	4.2	73	3.7	72	3.4
Greensboro--Winston-Salem--High Point, NC	30	3.4	42	3.0	70	1.6	66	4.7	74	3.7	80	3.0
Albuquerque, NM	31	3.4	68	1.6	55	2.2	36	6.4	23	6.4	17	6.0
Nassau-Suffolk, NY	32	3.4	56	2.4	64	1.8	74	4.3	78	3.3	76	3.2
Tucson, AZ	33	3.3	67	1.7	57	2.1	44	5.7	49	5.1	36	5.1
Middlesex-Somerset-Hunterdon, NJ	34	3.3	21	4.2	16	3.7	81	3.8	86	2.9	86	2.7
Birmingham, AL	35	3.2	47	2.7	26	3.3	8	8.3	16	6.7	19	5.8
Portland, OR	36	3.2	30	3.7	21	3.5	20	7.2	44	5.3	47	4.8
St. Louis, MO-IL	37	3.1	65	1.8	73	1.4	23	7.0	12	7.0	10	6.3
Albany-Schenectady-Troy, NY	38	3.0	49	2.7	43	2.5	56	5.2	68	3.9	68	3.6
Knoxville, TN	39	3.0	45	2.8	80	0.5	12	7.8	22	6.5	25	5.6
Kansas City, MO-KS	40	3.0	76	1.2	77	0.8	70	4.6	39	5.5	38	5.0
Toledo, OH	41	2.8	48	2.7	15	3.8	6	8.4	8	7.3	23	5.7
Providence, RI	42	2.8	53	2.6	71	1.6	79	4.0	71	3.7	77	3.1
Baltimore, MD	43	2.8	41	3.0	78	0.7	57	5.2	55	4.7	42	4.9
Honolulu, HI	44	2.7	22	4.2	61	1.9	73	4.4	77	3.5	85	2.8
New Haven-Meriden, CT	45	2.6	54	2.4	33	2.8	82	3.7	82	3.2	81	2.9
Dayton-Springfield, OH	46	2.6	61	2.0	51	2.3	31	6.6	36	5.6	32	5.2
Louisville, KY-IN	47	2.5	32	3.5	12	4.3	21	7.1	13	6.9	9	6.3
Oakland-East Bay, CA	48	2.5	40	3.2	30	3.0	42	5.9	50	5.0	50	4.6
Detroit, MI	49	2.5	74	1.2	79	0.7	9	8.2	6	8.1	4	7.7
Buffalo, NY	50	2.4	63	2.9	40	2.6	17	7.4	37	5.6	39	5.0
Scranton-Wilkes Barre, PA	51	2.2	57	2.3	39	2.6	7	8.4	14	6.9	15	6.0
Los Angeles-Long Beach, CA	52	2.2	52	2.7	50	2.3	29	6.7	31	5.9	45	4.9
Harrisburg-Lebanon-Carlisle, PA	53	2.2	29	3.7	44	2.4	62	5.0	67	4.1	63	4.0
Philadelphia, PA-NJ	54	2.1	50	2.7	62	1.9	54	5.3	61	4.4	59	4.1
Miami-Hialeah, FL	55	2.1	33	3.4	69	1.6	28	6.7	32	5.8	28	5.4
Boston, MA	56	2.0	58	2.2	63	1.9	87	3.2	87	2.7	86	2.8
Milwaukee, WI	57	2.0	51	2.7	28	3.0	39	6.1	43	5.3	61	4.0
Salt Lake City-Ogden, UT	58	2.0	78	0.6	56	2.1	51	5.4	33	5.7	48	4.8
San Antonio, TX	59	1.9	75	1.2	67	1.7	19	7.2	7	7.9	3	7.7
Bergen-Passaic, NJ	60	1.9	38	3.3	41	2.6	69	4.6	75	3.5	74	3.3
Wilmington, DE-NJ-MD	61	1.9	18	4.3	17	3.7	61	5.0	76	3.5	65	3.8
Jersey City, NJ	62	1.8	63	1.8	45	2.4	10	8.0	19	6.6	8	6.4
Minneapolis-St. Paul, MN-WI	63	1.8	27	3.9	37	2.7	77	4.2	64	4.4	70	3.5
Little Rock-North Little Rock, AR	64	1.8	66	1.3	27	3.1	24	6.9	11	7.1	7	6.4
Fort Worth, TX	65	1.7	79	0.5	82	0.2	32	6.5	15	6.9	11	6.3
Springfield, MA	66	1.7	37	3.3	59	2.0	76	4.2	80	3.3	75	3.2
New York, NY	67	1.6	73	1.2	74	1.4	27	6.7	45	5.3	56	4.3
Syracuse, NY	68	1.6	55	2.6	49	2.3	15	7.4	27	6.1	41	4.9
Akron, OH	69	1.2	69	1.6	42	2.5	11	8.0	9	7.1	14	6.1
Cleveland, OH	70	1.2	70	1.4	52	2.3	14	7.5	25	6.2	26	5.5
Omaha, NE-IA	71	1.2	59	2.1	48	2.3	52	5.4	46	5.2	60	4.0
Dallas, TX	72	1.1	80	-0.5	83	0.1	46	5.7	24	6.3	20	5.8
Rochester, NY	73	0.7	64	1.3	54	2.2	47	5.6	60	4.4	66	3.8
Chicago, IL	74	0.7	60	2.1	38	2.6	18	7.3	18	6.6	13	6.2
Austin, TX	75	0.7	83	-2.1	86	-1.1	48	5.6	20	6.5	16	6.0
Newark, NJ	76	0.6	71	1.4	66	1.8	53	5.3	65	4.2	64	3.9
San Francisco, CA	77	0.2	72	1.3	58	2.0	71	4.5	70	3.8	69	3.5
Allentown-Bethlehem, PA-NJ	78	0.1	46	2.8	60	1.9	22	7.1	51	5.0	55	4.4
Pittsburgh, PA	79	-0.1	77	1.1	68	1.6	13	7.7	17	6.7	22	5.8
Baton Rouge, LA	80	-1.5	81	-1.3	76	1.0	2	10.9	2	9.9	1	9.3
Denver, CO	81	-1.6	82	-1.6	84	-0.3	30	6.6	10	7.1	18	6.0
San Jose, CA	82	-1.8	62	2.3	53	2.2	43	5.8	58	4.5	62	4.0
Gary-Hammond, IN	83	-2.5	20	4.3	10	4.5	1	11.7	3	9.5	12	6.3
New Orleans, LA	84	-2.6	85	-2.1	75	1.1	3	10.8	1	10.0	2	9.3
Tulsa, OK	85	-2.6	87	-2.9	81	0.2	5	8.4	5	8.2	5	7.3
Oklahoma City, OK	86	-3.5	84	-2.1	85	-0.8	26	6.7	27	6.0	29	5.4
Houston, TX	87	-4.6	86	-2.1	47	2.3	4	10.2	4	9.0	6	6.8

Source: Salomon Brothers Inc

TABLE IV

ASSET COMPOSITION OF FAILED AND HEALTHY THRIFTS

	Severely insolvent institutions		All other FSLIC-insured institutions	
Year-end	Residential mortgage-related loans	Nontraditional investments	Residential mortgage-related loans	Nontraditional investments
1982	63.7 %	14.3 %	72.1 %	8.9 %
1983	54.7	24.3	67.6	9.7
1984	45.8	33.0	64.3	12.6
1985	38.9	40.8	61.9	14.6
1986	35.6	43.2	61.1	14.9
1987	33.5	44.0	62.0	14.6
June 1988	35.0	43.6	62.1	14.8

	Severely insolvent institutions	All other FSLIC-insured institutions
Number	210	2,507
Liabilities	$74.1 billion	$1,109.1 billion
GAAP equity	($22.3 billion)	$47.9 billion
Equity liabilities	-30.06%	4.32%

Source: J. Nahey, "Grade A Institutions Far Outnumber the Bad," Savings Institutions, January, 1989 (Original source: Federal Home Loan Bank Board) investments -- at least for government insured depository institution. Severely insolvent savings and loans had 44% of their assets in non-traditional investments and only 35% in residential mortgages, while healthy savings and loans had 62% of their assets in residential mortgage and only 15% in non-traditional investments. Over 85% of FSLIC losses were derived from the direct or indirect real estate development activities of the thrifts and not plain vanilla home mortgage lending.

Table V shows that rapidly growing thinly capitalized institutions were the cause of a significant portion of the losses incurred by FSLIC. The cases and risks were so obvious and apparent that it still is incomprehensible to me that no one stopped this risky activity, which resulted in the looting of the federal treasury.

II. Importance of the Thrift Industry to the Housing Market

Despite the asset side deregulation of 1982, the savings and local industry is still an essential element of the home mortgage finance system. Table VI and Figure I show that the savings and loans made nearly 50% home mortgage originations in the country in both 1980 and 1988. While their holding of home mortgages dropped from 50% of all mortgages to 42% in 1988, they still were clearly the most important source of home mortgage credit. Finally, Table IV, shown earlier, indicates that healthy savings and loans still held over 62% of their assets invested in residential mortgage loans.

These figures clearly show the vital linkage between home mortgage lending and the vast majority of good players in the savings and loan industry.

TABLE V

FAST GROWERS IN THE PAST ARE MAJOR PROBLEMS TODAY

Institution Name	Location	Tangible Capital as of March 1988	Liab. as of March 1988	GAAP Capital As of March 1988	Annualized Asset Growth 1st half of 1985	Tangible Capital as of Dec. '84	Tangible Capital to Assets as of Dec. '84
Sunbelt SA of Texas	Dallas, TX	-$1,699	$4,042	-$1,696	202%	-$13	-0.91%
Independent American[1]	Irving, TX	-699	1,635	-696	63%	-67	-5.72%
American Diversified[2]	Lodi, CA	-656	1,166	-656	27%	27	3.36%
University SA	Houston, TX	-623	4,232	90	26%	87	2.72%
Bright Banc SA	Dallas, TX	-562	4,795	-232	519%	33	5.58%
Commodore Savings	Dallas, TX	-435	1,151	-433	55%	12	2.06%
Security S & LA	Scottsdale, AZ	-291	1,076	-291	44%	-48	-5.24%
Sandia FS & LA	Albuquerque, NM	-287	1,308	-216	90%	-41	-6.42%
United SA of Texas	Houston, TX	-188	4,928	37	27%	-50	-1.28%
Commonwealth Savings	Houston, TX	-179	1,933	-172	52%	34	3.50%
Meritor Savings Bank[3]	Arlington, VA	-51	718	60	489%	-40	-15.07%
Blue Valley FS & LA	Kansas City, MO	-38	931	-38	27%	15	1.93%
Champion FS & LA[4]	Bloomington, IL	-37	2,399	77	54%	-88	-6.40%
First FS & LA	Austin, TX	-31	1,004	-18	84%	42	7.05%
Murray Savings	Dallas, TX	-26	1,436	-14	81%	30	4.88%
Allenpark Federal[5]	Houston, TX	-24	234	-24	62%	6	0.81%
Occidental FSB	Omaha, NE	-22	730	-17	79%	8	1.81%
Montfort Federal[6]	Dallas, TX	-13	1,222	-13	27%	30	3.31%
Charter FS & LA	Bristol, VA	-2	868	53	85%	-21	-4.84%
Altus Bank, A FSB[7]	Mobile, AL	-0	2,567	97	44%	-21	-1.56%
Totals/Averages		-$5,864	$38,377	-$4,104	73%	-$65	-0.30%

(Dollars in millions)

Source: Joint Statement of Gerald J. Levy, Chairman, Guaranty Savings & Loan Association, Milwaukee, WI, Herbert M. Sandler, Chairman, World Savings & Loan Association, Oakland, CA and Donald B. Shackelford, Chairman, State Savings Bank, Columbus, OH, Before the Committee on Banking, Housing and Urban Affairs of the United States Senate, August 2, 1988.

TABLE VI

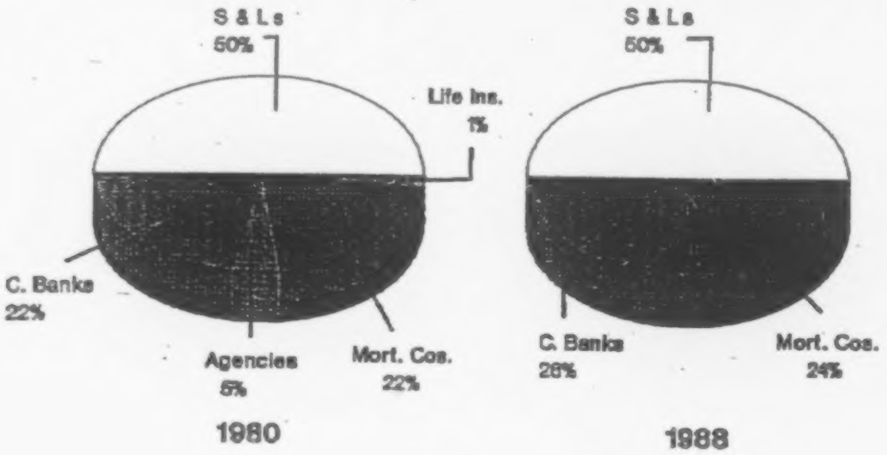
MORTGAGE ORIGINATIONS AND HOLDINGS BY TYPE OF INSTITUTION

	Single Family Mortgage Originations		Single Family Mortgage Holdings	
	1980	1988	1980	1988
Savings & Loans	50	50	44	44
Commercial Banks	22	26	17	25
Mortgage Bankers	22	24	1	1
Insurance Companies & Pensions	1	--	7	11

Source: Department of Housing and Urban Development

FIGURE I

Single Family Long Term Mortgage Originations



Source: Department of Housing and Urban Development

STATEMENT OF
JONATHAN E. GRAY
SANFORD C. BERNSTEIN & CO., INC.

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE UNITED STATES SENATE

MARCH 7, 1989

Summary Statement

The enormous loss in the FSLIC sector of the thrift industry is inextricably linked to financial deregulation, which has been poorly planned and poorly executed. Deregulation failed to cure actual or perceived ills, and has created serious new problems and risks, not the least of which being a loss in the thrift industry approximating $1,000 for every U.S. household.

Deregulation has altered the architecture of the financial system in a manner that greatly exaggerates the interest rate cycle. The fact that interest rates rose to historically high levels immediately after deposit rate decontrol was far from an unlucky accident. The elimination of deposit rate ceilings was an important contributing factor. Disintermediation, rather than an unpleasant side effect of monetary restraint, was the functional mechanism through which restrictive credit policies impacted the real sector of the economy. Moderate changes in rates relative to deposit ceilings allowed the Federal Reserve Board to divert funds from, or channel capital to, the housing sector. Housing was the brake pedal and the gas pedal. It still is. But without Reg Q, the Fed must use the cost of credit rather than its availability, as the means to impact the economy, thus producing magnified interest rate cycles.

At the same time that financial deregulation has magnified interest rate risk it has transfered this elevated rate risk to the consumer saver. Deregulation has spoiled the $2.0 trillion pool of consumer savings deposits as a source of fixed-rate mortgage financing, and forced conversion of one-fifth of the housing stock to Adjustable Rate Mortgages (ARMs), many of which instruments are not well designed. A rapid and substantial increase in interest rates could confront homeowners with an increase in monthly payments twice as large as growth in the average borrower's income. This could precipitate a wave of mortgage delinquencies, leading to forced home sales and potentially a material decline in residential real estate values.

Ironically, this would threaten the very consumer/saver that deregulation was meant to help, as the American consumer's savings are not so much in the form of financial assets, stocks, bonds, or deposits, but in the equity accumulated in his home. Such an outcome would almost certainly deepen any subsequent recession, would represent a tragedy in human terms, and could wipe out the thrift industry.

It is important to note that deregulation has yet to be tested in a bona fide credit crunch. From the perspective of the thrift industry there exists a double barreled risk of a serious underwriting problem from poorly designed ARMs, as well as an interest rate squeeze should short rates rise much above 11%-12%, where most ARMs would reach their lifetime rate CAPs.

The destructive effects of deregulation on the thrift industry have been naively brushed aside by the proponents of deregulation -- usually either its authors or its beneficiaries -- who argue that the rate rise of the late seventies and early eighties was merely an unfortunate accident of history, and moreover, that even without deregulation there would have been a thrift crisis, because there are simply so many bad loans.

But without deposit decontrol and the elimination of the Brokered Deposit Prohibition, the wholesale and profligate destruction of insured deposits could never have taken place on such a scale. Under Regulation Q, a $10 million in assets thrift with $500,000 in net worth could not have destroyed $800 million of insured deposits in a matter of eighteen months, because it would have been unable to attract more than its modest share of deposits paying the same rate as other institutions. Of course, the introduction of expanded asset authority within the context of a near total lack of supervision, examination and enforcement capability was a prescription for disaster. But even with an appallingly inept regulator, without deposit rate decontrol the thrift crisis in dollar terms might have been $10 billion or less, rather than $100 billion. More likely still, there would have been no thrift crisis at all.

The promised benefits of deregulation are difficult to pinpoint. It was supposed to provide the small saver a more equitable rate of return on his savings. Yet, yields available on deposits under Regulation Q rate control were fully competitive with open market rates over the course of an entire monetary and business cycle (see Exhibit 3). There was never any inequity to the small saver, merely the perception of an inequity when rates were high. It was supposed to cure the exaggerated housing cycles and help the thrift industry by eliminating disintermediation. The housing decline in the last cycle was the worst since the Great Depression (see Exhibit 2) and the effects on the thrift industry have been nothing short of toxic. Its growth rate has been cut by one third, and its aggregate profitability has been completely eliminated (see Exhibits 1, 4 and 5).

Curiously, at the same time that financial deregulation was supposed to remove government from the financial system as much as possible, the past decade has instead witnessed the virtual federalization of our largest financial market, as Federally sponsored mortgage agencies have gone from representing one sixth of mortgages outstanding and one quarter of mortgage growth, to 40% of total mortgages outstanding and 60% of the growth. The government mortgage conduits have served to catalyze the transfer of market share from thrifts and banks to mutual funds. They have reduced the profitability of the core residential mortgage market to thrifts and banks as they offer implicit (asset side) government insurance, and can thus confer a government guarantee upon the investment vehicles of those who compete with banks and thrifts, principally long-term fixed-income mutual funds.

The government mortgage agencies provide extremely valuable empirical data. They clearly demonstrate that the core business of thrifts remains profitable if properly underwritten, and that loss experience is actually well below the current insurance premium level of 20 basis points at FSLIC insured thrifts!

The healthy two-thirds of the industry has in aggregate just $35 billion of tangible capital, and earnings power in a more benign interest rate environment of perhaps $4.5 billion annually. The interest cost alone on the $90 billion price tag to resolve the deposit insurance crisis at a 9% bond rate is $8.1 billion.

The strongest two-thirds of the savings and loan industry, if not vigorous, is at least viable, provided that its capital base is not confiscated in a futile effort to force it to pay for losses that are not of its making.

The capital base that supported the thrift industry's participation in the residential mortgage market has been devastated. While, in an economic sense this occurred over the past decade, the Administration's proposed legislation will finally impose reality on the industry. The S&Ls originate nearly 50% of all residential mortgage loans and hold approximately 38% of the more than $2.0 trillion of residential mortgages outstanding. Fully one third of the industry is currently either dead or moribund (see Exhibit 7). Another 40%-45% of the industry, some 870 institutions with $550 billion in assets, will only be able to meet the 6% capital requirement which the proposed legislation seeks to impose by June 1991 if it achieves zero asset growth. Hence, as much as three-quarters of this industry has no capacity to finance growth in its holdings of mortgage assets, nor is it likely to regain any meaningful ability to do so for at least the next several years.

The price of mortgage assets will fall relative to other financial assets, and mortgage rates will rise relative to where they would otherwise have been (by perhaps as much as 25-50 basis points for the next few years) in order to induce more aggressive investment by banks and other investors. The only alternative would be to attract new capital investments. This however will be difficult. Why invest in a thrift that is taxed by SAIF at a substantially higher rate than a bank? Moreover, the effects of the 300 basis point rise in short-term interest rates since early 1988 is only now beginning to have its impact on the industry's income statement.

The public policy issue of whether or not it is desirable to have a specialized housing finance industry should be addressed explicitly, rather than left to events, for its maintenance may well require financial assistance.

The impact of deregulation on our financial markets and institutions, as well as the Federal Reserve Board's ability to control the business cycle, should be reexamined by policy makers.

Selective reregulation of the industry back to a more traditional focus on residential mortgage finance would be in the industry's best interest.

BERNSTEIN RESEARCH

FINANCIAL DEREGULATION AND THE SAVINGS AND LOAN CRISIS

Special Report

December 1988

Jonathan E. Gray

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Financial Deregulation
and
The Savings and Loan Crisis

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FINANCIAL DEREGULATION AND THE SAVINGS AND LOAN CRISIS

Introduction

The enormous loss in the FSLIC sector of the thrift industry is inextricably linked to financial deregulation, which has been poorly planned and poorly executed. Deregulation in the thrift industry failed to cure actual or perceived ills, and has created serious new problems and risks, not the least of which is an industry loss approximating $500 to $1,000 for every U.S. household.

Deregulation has altered the architecture of the financial system in a manner that greatly exaggerates the interest rate cycle. The fact that interest rates rose to historically high levels immediately after deposit rate decontrol was far from an unlucky accident. The elimination of deposit rate ceilings was an important contributing factor. Disintermediation, rather than an unpleasant side effect of monetary restraint, was the functional mechanism through which restrictive credit policies affected the real sector of the economy. Moderate changes in rates relative to deposit ceilings allowed the Federal Reserve Board (FRB) to divert funds from, or channel capital to, the housing sector. Housing was the brake as well as the gas pedal. It still is. But without Regulation Q, the FRB must use the cost of credit, rather than its availability, as the means to affect the economy, thus producing magnified interest rate cycles.

At the same time that financial deregulation has magnified interest rate risk, it has transferred this elevated rate risk to the consumer saver. Deregulation has spoiled the $2.0 trillion pool of consumer savings deposits as a source of fixed-rate mortgage financing, and forced conversion of a quarter of the housing stock to Adjustable Rate Mortgages (ARMs), many of which instruments are not well designed. A rapid and substantial increase in interest rates could confront homeowners with an increase in monthly payments twice as large as growth in the average borrower's income. This could precipitate a wave of mortgage delinquencies, leading to forced home sales and a potential decline in residential real estate values.

Ironically, this would threaten the very consumer/saver that deregulation was meant to help. The American consumer's savings are not so much in the form of financial assets -- stocks, bonds or deposits -- but in the equity accumulated in his home. Such an outcome would almost certainly deepen any subsequent recession, would represent a tragedy in human terms, and could possibly wipe out the thrift industry.

It is important to note that deregulation has yet to be tested in a bona fide credit crunch. From the perspective of the thrift industry there exists a double barreled risk of a serious underwriting problem from poorly designed ARMs, as well as an interest rate squeeze, should short rates rise much above 11%-12%, where most ARMs would reach their lifetime rate caps.

The destructive effects of deregulation on the thrift industry have been naively brushed aside by the proponents of deregulation -- frequently its authors or its beneficiaries -- who argue that the rate rise of the late seventies and early eighties was merely an unfortunate accident of history, and moreover, that even without deregulation there would have been a thrift crisis, because there are simply so many bad loans.

But without deposit decontrol, the wholesale and profligate destruction of insured deposits could never have taken place on such a scale. Under Regulation Q, a $10 million in assets thrift with $500,000 in net worth could not have destroyed $800 million of insured deposits in a matter of eighteen months, because it would have been unable to attract more than its modest share of deposits paying the same rate as other institutions. Of course, the introduction of expanded asset authority within the context of a near total lack of supervision, examination and enforcement capability was a prescription for disaster. But even with an appallingly inept regulator, without deposit rate decontrol the thrift crisis in dollar terms might have been $5-$10 billion or less, rather than $50-$100 billion. More likely still, there would have been no thrift crisis at all.

The promised benefits of deregulation are difficult to pinpoint. It was supposed to provide the small saver a more equitable rate of return on his savings. Yet yields available on deposits under Regulation Q rate control were fully competitive with open market rates over the course of an entire monetary and business cycle (see Exhibit 3). There was never any inequity to the small saver, merely the perception of an inequity when rates were high. It was supposed to cure the exaggerated housing cycles and help the thrift industry by eliminating disintermediation. The housing decline in the last cycle was one of the worst since the Great Depression (see Exhibit 2) and the effects on the thrift industry have been nothing short of toxic. Its growth rate has been cut by one third, and its aggregate profitability has been completely eliminated (see Exhibits 1, 4A, 4B and 5).

Curiously, at the same time that financial deregulation was supposed to remove government from the financial system as much as possible, the past decade has witnessed instead the virtual federalization of our largest financial market, as federally sponsored mortgage agencies have gone from representing one-sixth of mortgages outstanding and one-quarter of mortgage growth, to 40% of total mortgages outstanding and 60% of the growth. The government mortgage conduits have served to catalyze the transfer of market share from thrifts and banks to mutual funds. They have reduced the profitability of the core residential mortgage market to thrifts and banks as, armed with the government eagle, and unfettered by user fees, insurance premiums, or any meaningful capital constraint, they offer implicit (asset side) government insurance, and can thus confer a government guarantee upon the investment vehicles of those who compete with banks and thrifts, principally long-term fixed-income mutual funds.

The government mortgage agencies provide extremely valuable empiric data. They clearly demonstrate that the core business of thrifts remains profitable if properly underwritten, and that loss experience is actually well below the current insurance premium level of 20 basis points at FSLIC insured thrifts!*

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* - The top 70% of FSLIC insured institutions in terms of capital strength; i.e., those with GAAP capital over 3% also experience underwriting losses of just 21 basis points, and earn 51 basis points on assets, 58 adjusted for special insurance premiums (see Exhibits 7 and 8).

The strongest 70% of FSLIC insured savings and loans, with assets of roughly $900 billion, exhibit profitability and balance sheet characteristics comparable to those of the U.S. banking system. This sector of the industry is certainly viable provided its capital is not confiscated in a futile effort to force it to pick up the tab for losses that are not of its making. In this regard, it is remarkable that the Bank Board currently advocates a policy that would almost certainly destroy what remains of the industry whose safety and soundness is supposed to be its prime objective.

Regulatory Failure

Consensus estimates of the loss within the bankrupt sector of the savings and loan industry range from $50 to $100 billion, or about $500 to $1,000 for each of the roughly 90 million U.S. households. The principal source of this loss was the near total absence of any effective supervision and enforcement capability on the part of the Federal Home Loan Bank Board (FHLBB).

Consider the following anecdote: In June 1988, the FHLBB announced with some pride that it would be writing a check for about $800 million in connection with the liquidation of American Diversified Savings, a California S&L. The FHLBB characterized this action as a positive step on the part of the regulator, in that it would eliminate a "high rate payer" from the market that was boosting deposit costs to healthy thrifts.

It soon became known that American Diversified had been a mere $11 million in size at June 30, 1983 and had grown to $800 million in the next eighteen months. At liquidation its $1.3 billion in assets were worth less than 40 cents on the dollar, or $509 million, with a total cost to FSLIC of $800 million.

This anecdote is tantamount to a news report that a drunken motorist has wiped out the entire city of Pittsburgh.

A company with $11 million in assets lost $800 million. With perhaps $500,000 in equity, it destroyed $800 million of insured deposits, a kill ratio of 1,600 to 1. In terms of sheer destructive power, only the black hole in astrophysics would appear to be in the same league.

In 1983, the entire budget for examination and supervision at the Bank Board and the district banks combined was just $57 million, or roughly $40,000 in salary and support costs for each of the 1,380 full-time equivalent personnel engaged in examination and supervision. The loss at American Diversified Savings was fourteen times the national budget for supervision and enforcement, enough to pay for 32,000 supervisors at the average annual salary of $25,000 -- twenty-five times the total supervisory personnel in the entire regulatory system. This was enough to put ten supervisors in each of the 3,200 FSLIC insured S&Ls in the United States on a full time basis, for a full year. By contrast, each institution was examined on average just once every 18 months -- just the amount of time American Diversified needed to destroy $800 million of insured deposits.

The loss at Sunbelt Savings was $6.2 billion, or eight times as large as American Diversified Savings -- enough to pick up the tab for roughly 250,000 bank examiners, which would pay for nearly 80 full-time examiners for each of the 3,200 FSLIC-insured S&Ls. And, if even half of the low end estimate of losses in the industry of $50 billion could have been prevented through adequate supervision, the $25 billion saving could have fielded a standing army of one million examiners.

The purpose of comparing the enormity of losses on the one hand, with the paltry expenditures made to prevent such losses on the other, is to highlight the blatant mismanagement on the part of those in government who were either directly or indirectly entrusted with regulatory or oversight responsibility.

Granted, the economic hardship inflicted on the Southwestern United States by the collapse of petroleum prices represents a significant contributing factor to the current problems of the thrift industry and the banking system alike. Nonetheless, there have been bad lenders in virtually every major market area in the country, and their identity and identifying characteristics seemed to be a matter of common knowledge and concern to everyone but those with the power and responsibility to defend the safety and soundness of the system.

The principal cause of the S&L mess is bad government -- bad government in the form of a policy of financial deregulation that has been flawed, both in its design and in its execution.

The Effects of Deregulation on the S&L Industry

While the primary cause of the loss in the savings and loan industry seems straightforward, it is not quite so simple. There are important additional factors that have caused profound damage to the health of the thrift industry. Some of these forces are not widely understood or recognized. It is therefore appropriate that this discussion be expanded to a larger perspective, because the thrifts' current problems are inextricably intertwined with financial deregulation, its impact on the pattern of saving and investment in our society, and on the shape and severity of our economic and financial cycles. Indeed, if the objective of government policy had been to destroy the thrift industry, it is doubtful so clever, so toxic, and so multifaceted an attack could have been devised.

Ironically, the most critical event in our financial markets in the past fifty years was precipitated by a few thousand telegrams from a consumer activist group for retirees, the Grey Panthers, to several key members of Congress in the spring of 1978, urging that Regulation Q not be extended to money market mutual funds (MMMFs). The decision not to regulate money market funds was made for political reasons. Yet it catalyzed a profound transformation of our financial system that has progressed like a chain reaction, and has been justified, largely after the fact, in the name of deregulation.

The Arguments Advanced in Favor of Deregulation:

Equity for the "Small Saver"

Deregulation, it was argued, would provide small savers a more equitable rate of return on their savings, versus open market rates.

In fact, the yield on rate controlled deposits (deposits of $100,000 or less whose interest rate was limited by Federal Reserve Regulation Q) in the three decades prior to deregulation, averaged roughly 60 basis points above the yield on six-month Treasury Bills (see Exhibit 3). The comparison of Regulation Q controlled rates with those available on T-Bills seems apt, as both offered risk-free rates of return. In fact, a large fraction of the deposits in thrifts and banks were in amounts of $25,000 and up, and always had access to open market instruments. The element of safety and convenience, as well as yield, favored the deposit.

It is true that commercial paper yielded roughly 20 basis points more than Regulation Q controlled deposits, and nearly 50 basis points more in the decade just prior to deregulation.* It is also true that money market mutual funds concentrate their investments in commercial paper. However, after money market funds charge 75 basis points for expenses and management fees, it is difficult to identify any significant yield benefit to savers over the course of an entire monetary cycle, versus what would have been available with continued rate control.

Open market rates went above those available on Regulation Q controlled deposits during that phase of the business cycle when the Central Bank pursued tight credit policies, and fell below the deposit ceilings when the FRB sought to stimulate the economy out of recession. But, on average, over one or many business and monetary cycles there never was any inequity to the small saver versus the affluent.

Moreover, if the low-end estimate of $50 billion proves to be accurate for the loss in the S&L industry, and if, as we will argue, the principal cause of this loss is deregulation, then this loss alone (if divided by the $1.5 trillion of small time and savings deposits, that have been outstanding on average at banks and thrifts combined over the past decade of deregulation) represents an annual cost to savers/taxpayers of 33 basis points.

It seems difficult to identify benefits to savers, while it is easy to measure the cost to taxpayers.

Deregulation Would Help Housing and the Thrift Industry

Deregulation, it was argued, would be kinder to housing. It would eliminate disintermediation and diffuse the effects of tight credit more equitably across all sectors of the economy, rather than periodically visiting doom and destruction on the housing sector in a disproportionate way. Moreover, in eliminating disintermediation, it would be good for the thrift industry.

Between the peak in the second quarter of 1978, and the trough in the fourth quarter of 1981, housing starts fell from a rate of 2.1 million to 873,000, a decline of nearly 60%, roughly matching the steepest prior decline of the post-war era, and establishing a new record for the deepest sustained slump since the Great Depression (housing starts averaged 916,000 from third quarter 1981 through second quarter 1982). Deregulation has not been good for housing (see Exhibit 2).

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* - These premiums are reduced to just 7 and 25 basis points, respectively, giving effect to daily compounding of deposit rates.

Deregulation has been toxic for the thrift industry. Its growth rate has been cut by a third (and will be reduced far more as the dead and moribund institutions are buried), and its profitability (in aggregate) has been entirely eliminated (see Exhibits 1, 4A, 4B and 5).

It was the position of some that regulation simply could not be maintained. The FRB had no authority to regulate money market mutual funds or, it was frequently argued, the intermediation process would simply move offshore.

Neither argument seems convincing. The FRB's authority could have been extended with a stroke of the Congressional pen. The ability of our banks to accept deposits offshore, beyond the reach of rate control, could also have simply been forbidden to U.S. banks. Foreign banks could have been banned from doing business in the U.S. for non-compliance.

In theory, regulation limits competition, and therefore raises costs that must be borne by consumers. Yet the regulatory system of deposit rate ceilings, deposit insurance, and a quasi-monopoly setting for depository institutions, was explicitly created to spare our society certain costs -- the costs of foregone wealth creation as a consequence of exaggerated volatility in our business cycles, the trauma of precipitous declines in output, chronic high unemployment, and the inequities and dislocations associated with oscillating between periods of inflation and deflation, and of course, the cost of financial institution failures. The three decades from 1948 to 1978, contrasted with the century before, seem an eloquent endorsement of its usefulness.

There are specific costs that our system has paid, is paying, and will continue to pay as a consequence of deregulation. Where are its benefits? Those originally identified as the rationale for deregulation seem clearly to have been discredited.

The Effects of Deregulation on the Consumer/Saver and the Federal Reserve's Ability to Control the Economy

In some sense, deregulation has eliminated disintermediation. Unfortunately, disintermediation, rather than an unpleasant side effect of monetary restraint, was the primary mechanism through which tight credit policies had an impact on the real sector of the economy. The elimination of Regulation Q also eliminated the Central Bank's most effective means of control over the availability of credit. As a consequence, the FRB has instead had to rely upon its ability to control the cost of credit, which has led to magnified interest rate cycles.

Regulation Q ceilings were extremely useful as a threshold mechanism. When the FRB pushed rates above deposit ceilings, disintermediation and credit starvation in the mortgage and housing markets soon followed, efficiently inducing housing-led recessions that would idle resources and cool price inflation. When the FRB eased, open market rates would fall until they went below the rates offered on deposits, which would return the flow of financial capital to mortgage lending institutions, drop mortgage rates, and boost housing, helping to stimulate recovery.

Housing served as both the brake pedal and the gas pedal. It still does. Without Regulation Q, the effects of restrictive credit policies on the real sector of the economy are still delivered via sharp contractions in residential construction expenditures. It merely necessitates a rise in rates that is so severe that borrowers gag on the cost of mortgage credit, even though credit remains available.

The coincidence of an historic rise in interest rates with the dismantling of deposit interest rate ceilings was far from an accident. The creation of floating rate deposits tied to T-Bills was an important contributing factor to the subsequent historic rise in open market rates.

The Legacy of Deregulation is Not Higher Returns, But Higher Risks for the Consumer/Saver

At the same time that deregulation has led to exaggerated interest rate cycles and therefore heightened interest rate risk, it has simultaneously shifted the burden of this elevated rate risk from lending institutions to consumer/savers and the American homeowner. The deregulation of deposit interest rates has spoiled the $2.0 trillion pool of consumer savings at banks and thrifts as a source of financing for long-term fixed rate mortgages, and has forced conversion of a significant fraction of the $2.2 trillion of residential mortgages to adjustable rate form. Moreover, the length of the current economic cycle has provided an extended period of relatively stable and low interest rates, and during this calm in the credit markets, one out of every four owner-occupied homes and apartments has been financed with an Adjustable Rate Mortgage (ARM).

The garden variety ARM is indexed to the one-year T-Bill, and has a 200 basis point annual, and a 500 basis point lifetime rate cap. With the one-year Bill at roughly 6 3/4% for two and one-half years (1986:Q1-1988:Q2), these loans were made at about 9 1/2%, 275 basis points over the Bill rate.

If T-Bills rose 500 basis points over 2 1/2 years, to 11 3/4% by late 1990 (the one-year Treasury is currently at 9.10%, up 240 basis points in the past eight months) the rates on these mortgage loans would go from an average of 9 1/2% to 14 1/2%, and the monthly payments would rise 55%, more than twice as much as the average borrower's income over the same period, as nominal wages are likely to grow at roughly a 7% annual pace in the latter stages of the current business cycle. This could threaten serious default experience. Moreover, not all borrowers' income would be up at the average rate. Some would be up more, some would experience no income growth, and some would see their earnings decline.

We estimate that about 15 million homes have been financed with ARMs of some kind out of an estimated 29 million total units financed since 1982, or about 25% of the 58 million total owner-occupied dwellings in the U.S. We further estimate that about 12 million units currently remain ARM financed (i.e., assuming 3 million ARM refinances into fixed-rate loans since 1985).

The number of units financed with ARMs during the 2 1/2 year trough in rates (1986:Q1-1988:Q2) is estimated to be roughly 7 million units. If even one in twenty of just these ARM borrowers cannot meet the higher payment and places his home on the market for sale, this could mean 350,000 units dumped on a fairly thin, illiquid market, which could in turn precipitate a decline in residential real estate values on a national scale. In low rate environments such as 1985-1987, 5.0 million homes are traded or built annually. But in credit crunches the market clears just 2.5-3.0 million homes. The incremental supply therefore would not be insignificant, particularly given the forced nature of such sales and their increased tendency to soften marginal pricing.

The most glaring inequity of such an event would be that the most recent homebuyers could see virtually all of their life-savings wiped out. The consumer sector stores its wealth not so much in stocks or bonds, but in the equity that has accumulated in the housing stock. With about 58 million homes worth roughly $112,000 each, the market value of the housing stock is currently about $6.5 trillion, and net of $2.2 trillion of mortgage debt, represents a $4.3 trillion pool of wealth. Any material damage to this store of consumer wealth could certainly act to deepen the severity of some future recession.* Any material decline in the value of residential real estate would threaten to destroy the thrift industry, and would inflict substantial damage on many commercial banks, financial institutions, and non-financial businesses. Presumably, the damage could radiate out to other businesses as homeowners, just marginally able to meet rising monthly mortgage payments, might stop payment on other types of consumer credit in order to forestall mortgage default.

One of the main costs of deregulation is not so much the certainty of such a scenario, or even its probability, but merely its risk. Just the fact that deregulation elevates such a scenario to the realm of plausibility, is an indictment of its logic and certainly of the sloppy manner in which our policy makers seem to have backed into it.

Ironically, by threatening home prices, deregulation threatens the very constituency it was supposedly designed to benefit, the small saver whose wealth is mainly the accumulated equity in his home. Financial deregulation has magnified interest rate risk and simultaneously transfered this elevated degree of risk to the consumer. When the time comes for the Central Bank to administer restrictive credit policies, no longer will it affect just the cost to purchase a home, but the cost to carry a home as well.

Poorly Designed Policy, Poorly Executed

The thrift industry was actually legislated into a particular, well defined structure, and that structure was subsequently made non-viable by government policies of interest rate deregulation. A system that was in place for thirty years was effectively eliminated over three or four years. Change was implemented at a pace so rapid that adaptation for survival was all but impossible.

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* - The risk of a deep deflationary depression would remain extremely unlikely, as the payments mechanism would remain undisturbed. Economic activity seems relatively immune to changes in the stock of wealth alone, as the crash of October, 1987 bears evidence.

To begin with, the deregulation of deposits prior to the deregulation of mortgages, given that the effective life of a conventional fixed rate mortgage was about ten to twelve years while average deposit maturities were certainly under two years, seemed a prescription explicitly designed to attack the thrift industry's net worth. ARMs were actually prohibited to federally chartered S&Ls or to banks prior to 1981. The industry was required to maintain the preponderance of its assets in mortgages or suffer negative tax consequences. In other words, it was required to make thirty-year fixed rate mortgages.

The Regulators Failed the Test of Deregulation, in Part Because They Didn't Do Their Homework

The plan to deregulate deposits relied on a $10,000 minimum denomination money market certificate (MMC) tied to the six month T-Bill. Surely so high a minimum would retain sophisticated affluent borrowers who might otherwise disintermediate while it would block the bulk of thrifts' small depositors from transferring to the new account. Or at least, so the regulators thought. Unfortunately, as it turned out, while the average thrift deposit was only about $2,000-$3,000 per account, more than 40% of passbook accounts and 60% of certificates by dollars were in amounts of $10,000 and up with access to the new account. We believe no adequate survey was officially conducted, although it took us only a few hours in May, 1978 to complete a preliminary survey.

Within 18 months after its introduction, the MMC had captured one-quarter trillion dollars in deposits, 25% of the total at banks and thrifts combined, and become the most successful account in history. In the process, it blocked the FRB from inducing a classical housing led recession. Of course the FRB didn't give up. T-Bills reached 16% from their initial seemingly innocuous 7% level when the MMC was introduced, and 85% of thrifts nationally ran enormous losses.

Within four years the S&L industry's net worth ratio was cut by a third, from $5.50 to $3.70 per $100 of assets, and its capital was roughly $20.0 billion below what it would have been had asset growth and profitability continued at their pre-deregulation trend rates.

What Do You Do If You Can't Make The Grade, and Can't Fail? Well, You Can Always Cheat Just a Little

The FHLBB, fearing a financial panic, chose what it regarded as the lesser of two evils. Fearing that the spectre of widespread failures might precipitate a financial panic, it opted instead to accept accounting rules that served to cloak the appearance of losses, and to induce healthy companies to acquire bankrupt entities under the umbrella of illusory earnings and Alice-in-Wonderland net worth. Though entirely in keeping with GAAP accounting, the application of purchase accounting to thrift acquisitions during 1981 and 1982 produced patently absurd distortions of economic reality, and served to denigrate the integrity of the industry's financial statements. The effect was to transform bankrupt companies that were bleeding red ink into profitable entities, as they passed through the veil of accounting theory and onto the balance sheet of the acquiring companies.

Goodwill was deemed to be directly proportional to the extent to which an acquired company's mortgage assets were under water. The more under water, the more illusory income could be generated from an accounting standpoint in the early years after an acquisition. Given a choice between acquiring two different thrifts, one whose loans yielded 9% and another 7%, the latter produced far more illusory income and illusory net worth subsequent to the acquisition.

It was possible to sell assets at a loss on a cash basis and report a profit on a financial reporting basis. A dividend could be declared from the financial basis gain, and paid with cash coming from insured deposits, the dividend not taxable to shareholders because in the eyes of the IRS (and in reality) there was a large loss, and so the dividend represented a return of principal. It was actually possible to sell assets at a loss on a cash basis and put the financial basis profits aside as reserves to absorb the losses on bad loans!

The damage done to the industry went far beyond the damage to the integrity of its financial statements. Managements frequently made decisions that produced accounting benefits, though the economic impact on their companies was destructive. Some did this out of ignorance, others knowingly. (More on bad accounting below.)

The Magnitude of the Bad Loan Problem is Also the Direct Result of Deregulation

Some will argue that deregulation and its mismanagement may have contributed to the industry's current insolvencies but cannot be solely, or even primarily responsible, because the interest rate turn was just bad luck, and most important, there are all these bad assets that seem to have little to do with deregulation.

With rate ceilings, everyone pays the same rate for deposits. There is no way for a bad lender to attract a lot of insured deposits quickly and destroy them.

However, with rate deregulation, if you pay over the market for money you can buy it in limitless quantity and fast. It is irrelevant to the insured depositor whether his deposit is invested soundly or foolishly. Thus, the marketplace won't put a bad lender out of business by cutting off his supply of funds. You need a policeman. You need lots of policemen.

The combination of rate deregulation, deposit insurance (an absolute necessity) and the complete absence of any effective supervision, examination and enforcement by federal or state regulators gave rise to the wholesale and profligate destruction of insured deposits (and almost certainly taxpayer funds as well). To date the healthy segment of the industry has been left with the tab in the form of burdensome insurance premiums, and an operating environment where rational pricing was eroded by the availability of illusory accounting profits, and in a significant number of instances, by flagrant misconduct and fraud.*

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* - The Committee on Government Operations report, "Combating Fraud, Abuse and Misconduct in the Nation's Financial Institutions," October, 1988 was able to specifically identify $8.2 billion in losses to the FSLIC as the direct result of misconduct. However, it went on to state that the FHLBB included only those S&Ls where misconduct was detected prior to insolvency, and that the FHLBB had seriously understated the extent to which misconduct was involved. Even on this basis however, nearly 25% of the cases reviewed seem to have involved legal misconduct.

The explanation for what has occurred is apparently that the philosophical adherents of deregulation within government failed to comprehend that deregulation increased the need for supervision, because there is a fundamental contradiction between deregulation and deposit insurance.

Which is to say that if deposit insurance is desirable, (we would argue absolutely desirable) then deregulation could only have been conducted within well defined parameters. Rule making could only be relaxed in a controlled way, slowly and with considerable deliberation as to its effects, and only within the context of increased supervision.

The Interest Rate Earthquake of 1978-1982 Had an Aftershock: The Refinancing Wave of 1983-1986

The asymetry of the industry's profit history (lose money when rates are high, lose money when rates are low) also reflects the interaction of magnified interest rate cycles resulting from Regulation Q's phase-out, with the propensity of the fixed-rate mortgage to refinance given a large enough decline in rates.

Prior to deregulation, there were scarcely any interest rate declines of adequate magnitude to trigger refinancing. Since deregulation, the value of the borrower's option to refinance has skyrocketed, and come out of the industry's profit stream (see Exhibit 6).

Heads I Win, Tails It's a Long-Term Investment

Current accounting rules permit distortions of the true economic condition of thrift institutions, and divert management from operating strategies that will enhance the long-term economic value of their firms.

The conversion of 20% or more of the industry's mortgage assets to highly liquid mortgage backed securities has fostered aggressive trading. This has had the effect of selectively marking-to-market any security that will produce a gain, while below-market mortgage securities are carried at historic purchase cost. Thus earnings are inflated, and net worth comes to reflect the higher of cost or market.

Consider the following: between 1982 and 1987 Financial Corporation of America reported $1.3 billion in gains on sales of mortgage backed securities (MBS), yet at December 31, 1987 it had an unrecognized mark-to-market loss in its $18.2 billion MBS portfolio of $1.6 billion. In other words, the disparity between economic reality and the accounting profession's presentation of that reality was $1.6 billion. During this five year period Financial Corporation's annual average MBS turnover was 110%, and its gross trading volume just under $100 billion cumulatively.

If it is possible to show a profit when you have a loss, the illusory profit can be paid out as a dividend, and the cash flow obtained from deposit growth. Unless current accounting rules are drastically revamped, the safety of insured deposits can never be secured.

The Federalization of the Mortgage Market, or Where is Capitalism at Work?

How is it that an industry can earn a substandard rate of return on investment for a decade? Where is capitalism at work? Companies should exit, capacity should shrink, and pricing and the return on investment should be restored.

Capacity has not shrunk for several reasons.

The FHLBB has failed to shut down bankrupt entities whose return on investment has been decidedly negative. In first half 1988 each of the insolvent companies (about a sixth of the total) lost the equivalent of what twenty companies with a comparable volume of assets would earn (see Exhibits 7 and 8).

Moreover, capacity has not shrunk because the securitization of the mortgage market has facilitated the wholesale transfer of market share from depositories to mutual funds, with the government conduits, Freddie Mac, Fannie Mae and Ginnie Mae serving as catalysts, in effect insuring the mortgage asset and thereby undermining the thrift and banking industries' franchise as the risk-free depositories for the consumer's savings capital. The bond-like government guaranteed character of agency mortgage-backed securities (MBS), precludes the need for the portfolio manager to know anything about real estate. The saver-investor gets asset side government insurance. While thrifts continue to dominate the origination of mortgages, their substandard profitability has forced them to sell an increasing fraction of their production to mutual funds, who in turn have advertised high government guaranteed yields on long-term fixed income funds. As a result the thrifts long-term savings customers have abandoned them for mutual funds. Net of load charges and management fees, the actual yield advantage of long-term fixed income funds is unclear, particularly when the principal risk to the consumer is taken into account.

While the very term deregulation promises a loosening of presumably stultifying constraints upon the ingenuity of the free marketplace, in fact the past ten years have witnessed the virtual federalization of our largest financial market by the government conduits (see Exhibits 4, A and B).

They have attacked the thrift industry's ability to earn a living net by unbundling the origination and investment functions through the securitization process, but by doing so with implicit Treasury support. The value of the Federal Government's implicit guarantee of the agency mortgage backed security is converted to guarantee fees by the conduits, whose $800 million in aggregate net income in 1988 will represent 30% of the entire S&L industry's earnings in 1985, its best year of this decade, when it earned $2.6 billion. In federally insuring the mortgage loan against loss they have made the instrument a commodity, increased the supply of investment capital, and lowered the rate of return and profitability of the mortgage warehousing function performed by thrifts, and to a lesser extent by banks.

This is what the agencies were supposed to do, to a limited extent, and for low income housing. But is federal sponsorship of the entire mortgage market what anyone sought? Has the government's role in the markets increased the thrift loss that will be paid for by the consumer as taxpayer? As policymakers demand that capital be the buffer that stands between losses and the taxpayer, where, they may ask, is the capital of the mortgage agencies? Will Ginnie Mae, Fannie Mae, Freddie Mac, Sallie Mae, and Farmer Mac, be followed by Business Mac and Consumer Mae? This is a question that the banking industry may well wish to ponder.

The federally sponsored mortgage agencies were created to increase the flow of capital to low income housing, to enhance the liquidity of the mortgage instrument through the development of a secondary market, and to act in a countercyclical fashion to moderate the volatility of the housing cycle. While these are certainly worthwhile objectives, the agencies have gone well beyond the original legislative intent.

Is the Thrift Industry Obsolete?

This question must be clarified. The question may be interpreted as asking either or both of the following:

a) Should thrifts continue to perform their core functions of accepting insured consumer deposits, and financing residential dwellings, but perform these functions as part of the banking system?

b) Should homeownership be financed in some other way?

There is no logically necessary reason for maintaining a separate industry to provide housing finance. However, there is no compelling reason for eliminating such an industry either. The industry's problems must be cured whether or not it remains independent. As long as the industry is properly supervised, it will function in a manner that does not require taxpayer bailouts.

As to the hypothesis that homeownership be financed in some other way, it must first be understood that thrifts not only perform a mortgage warehousing function, but a savings/investment function as well.

The only other way to finance the residential mortgage market would require complete federalization, the opposite of deregulation. The entire mortgage market would be converted to MBS by the government agencies and financed directly by consumers who would purchase long-term, fixed-income mutual funds (i.e. GNMA funds and the like). The taxpayer would still be exposed to the underwriting risk, as he is now through the agencies' implicit or explicit links to the Treasury.

The problem with financing the entire mortgage market in this fashion is that it transfers a significant amount of principal risk to the saver/investor, and there is a lot of evidence to support the notion that the consumer is substantially risk averse. He wants a safe haven for his life savings. For example, after growing from $64 to $284 billion in the two years prior to the bond market sell-off of April 1987, long-term bond and Ginnie Mae funds fell by $32 billion in the next six months as consumer savers fled before the spectre of some $20 billion of principal losses. And when the market crashed in October 1987, the savings poured into banks and thrifts.

Furthermore, it is important that would-be architects of our financial system be cognizant of the size and importance of the mortgage market.

At the end of 1987 there was $8.3 trillion of total credit market debt owed by consumers, non-financial business and government combined. Of this amount, $2.5 trillion was government debt, leaving just $5.8 trillion of private sector debt. The mortgage market was $2.9 trillion in size, of which $2.2 trillion was residential. By comparison, no other sector of the market comes close. It is five times the size of bank loans ($660 billion), four times the size of consumer credit ($700 billion), and four times the size of the corporate bond market ($760 billion). Whether mortgage investment is done through a separate industry called the thrift industry, or through the banking system, the thrift function -- funding mortgages with insured deposits -- will persist as the largest and most important sector of the financial system.

In a sense, deciding that we don't really need the thrift industry any more, is a little like deciding to get rid of the Atlantic ocean. When you look for a place to put all that salt water, the only place that's large enough is the trench between the Americas and Europe. Financing mortgages with savings deposits... financing the consumer's home with a liquid instrument that doesn't place the consumer's principal at risk -- is the thrift industry.

How Much of the Thrift Industry is Viable?

Exhibit 7 presents cross sections of the FSLIC insured sector of the Savings and Loan industry by GAAP capital ratios, and for the industry in aggregate. The insolvent sector holds $188 billion, or 15% of the $1.3 trillion in total industry assets. These 495 GAAP-insolvent institutions have in aggregate minus $26 billion in GAAP capital, or a (14.9)% capital to assets ratio. The relationship between interest earning assets (loans and investment securities) and interest costing liabilities (savings and borrowings) is even more dramatically unfavorable, as these companies pay interest on $56 billion of interest costing deposits and debt that is tied up in non-earning assets, primarily goodwill and foreclosed real estate. At an 8% cost of funds, the cost to finance this excess of interest costing balances is $4.5 billion annually (8% x $56 billion = $4.5 billion), or 240 basis points on assets. These institutions can barely be considered intact cadavers.

Another $219 billion of industry assets are held by companies with GAAP net worth averaging 1.8% of assets and running losses at the rate of 45 basis points. As Exhibits 7 and 8 show, if the underwriting losses of this sector magically dropped to the 20 basis point level of the top two-thirds of the industry, it would just be breaking even. Its excess of interest costing liabilities is $16.5 billion or (8.6)% of assets. Given the rise in open market rates that has already occurred, the rate of loss for this population will likely rise toward 75-100 basis points within 12 months, pushing half into insolvency by the summer of 1989, and lead most of the rest to a similar fate within 24 months.

The top two-thirds of the industry by assets, and 85% by number of institutions, is quite sound, with an aggregate GAAP net worth ratio of 5.9% and an average ROA of 0.51%, or 0.58% at the same deposit insurance premium level as the banking system.

How Much of the Tab for the Insolvent Can the Healthy S&Ls Be Expected To Pay?

The healthy two-thirds of the industry has $35 billion of tangible GAAP capital, the unhealthy third has minus $33 billion. With $883 billion in assets and assuming a long-term ROA of 60 basis points, the surviving healthy sector will only generate $5 billion in net income annually. If the loss in the unhealthy sector turned out to be $75 billion, and if the entire loss were financed with long-term Treasury debt at a 9% cost, the interest alone, after taxes, would be $4.1 billion annually. Just this debt service cost would absorb virtually all of the future profits of the healthy sector of the industry in perpetuity. This would eliminate the industry as a source of financing for home ownership, and the loss would still not be paid, as the debt would some day have to be retired!

It is not feasible for the healthy to pick up the tab without committing financial suicide, nor would it be fair to require them to do so, as they have little or no culpability for a crisis that is the offspring of poorly designed policies, poorly executed.

Recommendations:

1) The first priority must be to stop the losses. This means adequate supervision, examination and enforcement. If the present regulatory structure is maintained, this can probably be achieved only through the re-regulation of thrifts back to their traditional niche in the residential mortgage market.

The experience of the government mortgage agencies provides extremely valuable empiric evidence. It clearly demonstrates that, properly underwritten, the loss experience in the thrift industry's traditional market is actually less than the current FSLIC insurance premium of 20 basis points, perhaps half as much. Re-regulation that returned the thrift industry to its traditional role of residential mortgage lending would probably confer an economic benefit on the industry in aggregate, as evidence strongly supports the perception that the most profitable thrifts are those that have retained their traditional focus. The mortgage market is so large that specialization would hardly constitute confinement.

Direct investment in real estate should not be permitted within the insured portion of thrifts.

2) The Federal Home Loan Bank Board should study Adjustable Rate Mortgage (ARM) product design, and develop a contingency plan for the possibility of an underwriting crisis in the ARM sector of the mortgage market. We recommend: a) negative amortization, and rate indexation to the industry's cost of funds rather than to an open market rate, b) prohibiting "teaser" rates, and c) requiring income qualification of borrowers at the average of the introductory and maximum rates, as a means to improve ARM product safety.

3) The FHLBB, FSLIC or successor institutions, should take a few dollars of every thousand dollars of insurance premiums, one or two million of the one or two billion raised in insurance premiums each year, and use this money to hire a private actuary. It should turn over the tons of data collected, and ask that an actuarial base be developed for the non-conforming and conforming sectors of the market. The time is over when the FHLBB can be a financial regulator without financial expertise. Running an insurance fund with no way to measure risk has been one very expensive mistake.

An analysis should be done to determine how to assure quality control through the supervision and examination function. How often must a company be examined; how many loans selected randomly and looked at to verify that the underwriting and appraisal criteria have been adhered to; what is the time lag between origination and delinquency by type of loan, etc. In an industry where the traditional line of business has historically had just one problem loan in fifty, the regulator should ascertain why it has been unable to detect portfolios where half or more of the loans are bad.

4) The FHLBB should require detailed disclosure of each institution's financial structure, its profitability and creditworthiness. If under deregulation the markets are to impose discipline, they must have information. Uninsured creditors of failed thrifts should not be shielded from loss by the FSLIC. Where fraud has been responsible for losses, criminal prosecution should be aggressively pursued.

5) Accounting rules must be reformed. As long as it is possible to report a profit, when the reality is a loss, the safety and soundness of the insured deposit system cannot be secured. The 25% of thrift mortgage assets that have been converted to Mortgage Backed Securities, over $200 billion, are now essentially trading portfolios that are routinely used to recognize gains and defer losses. The effect is to inflate earnings, and to state net worth at the higher of cost or market. Instead, trading profits should be offset against mark-to-market losses related to mortgage backed securities, before any net gain is allowed to flow through income and be reflected in net worth.

Present valuation of future streams of loan servicing fees should be discontinued.

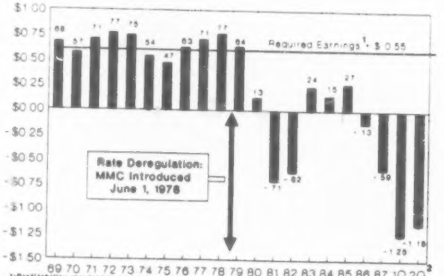
6) Some contingency plan should be studied for the reimposition of interest rate ceilings for both depositories and mutual funds as a means to restore Federal Reserve control over credit availability, if only to be held in reserve for use in extreme circumstances -- for example, should homeowners seek relief from adjustable mortgages in a particularly severe credit cycle.

7) In real terms, our society has already absorbed the loss. We have our insured deposits, principal and interest, including those tens of billions of dollars worth that were used to mis-allocate real resources within our society. We have empty office buildings and uneconomic shopping malls instead of much needed housing where shortages exist. The taxes that will eventually be used to pay for this loss could have been put to an enormous amount of good.

It would be counterproductive and unfair to bleed the healthy segment of the industry to death trying to force it to pay for the losses of the insolvent. The crisis is largely the making of poorly planned and poorly executed government policy. Damage to the financial strength of the healthy sector will only lead to higher mortality rates and higher losses in the long run, and may interfere with the flow of capital to the housing sector.

The Treasury should pay for the burial costs of the dead and the moribund, because there is no alternative, and because this is what it means to stand behind the insured deposit system.

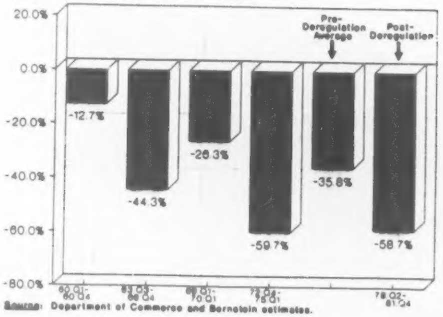
Exhibit 1
NET INCOME PER $100 OF ASSETS (ROA)
U.S. SAVINGS & LOAN INDUSTRY



1-Profitability required to maintain market share without an increase in leverage (assumes a 6% capital ratio and 1% growth in assets)
2-1st and 2nd quarters 1988 at annual rate.

Source: FHLBB and Bernstein estimates.

Exhibit 2
HOUSING CYCLES
Peak to Trough Declines in Housing Starts



Source: Department of Commerce and Bernstein estimates.

Exhibit 3

Rates Available to Small Savers Before Deregulation Versus Open Market Rates

	Regulation Q Banks[2]	T-Bills (3 mos.)[1]	Reg Q Less T-Bill	Commercial Paper (3 mos.)[3]	Reg Q Less CP
1952	2.50%	1.75%	0.75%	2.20%	0.30%
1953	2.50	1.89	0.61	2.41	0.09
1954	2.50	0.96	1.54	1.45	1.05
1955	2.50	1.79	0.71	2.24	0.26
1956	2.50	2.70	(0.20)	3.13	(0.63)
1957	3.00	3.21	(0.21)	3.64	(0.64)
1958	3.00	1.87	1.13	2.18	0.82
1959	3.00	3.53	(0.53)	3.88	(0.88)
1960	3.00	2.85	0.15	3.55	(0.55)
1961	3.00	2.40	0.60	2.71	0.29
1962	4.00	2.81	1.19	3.19	0.81
1963	4.00	3.20	0.80	3.52	0.48
1964	4.07	3.55	0.52	3.99	0.08
1965	4.57	3.96	0.61	4.36	0.21
1966	5.37	4.83	0.54	5.72	(0.35)
1967	5.00	4.31	0.69	5.23	(0.23)
1968	5.00	5.32	(0.32)	6.13	(1.13)
1969	5.00	6.62	(1.62)	8.14	(3.14)
1970	5.71	6.44	(0.73)	8.00	(2.29)
1971	5.75	4.34	1.41	5.19	0.56
1972	5.75	4.08	1.67	4.79	0.96
1973	6.25	6.96	(0.71)	8.51	(2.26)
1974	7.26	7.77	(0.51)	10.44	(3.18)
1975	7.50	5.77	1.73	6.45	1.05
1976	7.50	4.99	2.51	5.38	2.12
1977	7.50	5.25	2.25	5.70	1.80
1978	7.88	6.87	1.01	8.22	(0.34)
27 Year Average = (1952 - 1978)	4.65%[4]	4.07%	0.58%	4.83%	(0.18)%[4]
10 Year Average = (1968 - 1978)	6.61%[4]	5.91%	0.70%	7.08%	(0.47)%[4]

1 - Discount basis.
2 - Maximum prevailing Q ceiling; excludes effects of compounding.
3 - Bond equivalent yield.
4 - With daily compounding the 27 year and 10 year average yields for deposits became 4.76% and 6.83% respectively, and the commercial paper rate premiums are cut to just 7 and 25 basis points respectively.

Source: Federal Reserve Board and Bernstein estimates.
(45/8)

Exhibit 4A

Financial Deregulation: The Losers

	The Banking Industry				The Savings & Loan Industry				
	Total Assets[1]	Annual Asset Growth	Return on Assets	Net Worth Ratio	Total Assets[2]	Annual Asset Growth	Return on Assets	Net Worth Ratio	Net Worth ($ bil)
1968	$ 500.0				$ 152.9		0.61%		
1969	526.0	5.2%	0.81%	7.2%	162.3	6.1%	0.68	6.9%	$11.2
1970	570.4	8.4	0.90	7.1	176.6	8.8	0.57	6.8	12.0
1971	633.0	11.1	0.88	6.9	206.3	16.8	0.71	6.4	13.2
1972	731.1	15.4	0.84	6.6	243.1	17.8	0.77	6.3	15.2
1973	825.1	12.9	0.86	6.5	272.4	12.0	0.75	6.3	17.1
1974	904.2	9.6	0.82	6.5	295.5	8.5	0.54	6.2	18.4
1975	930.9	3.0	0.79	6.0	338.4	14.5	0.47	5.8	19.8
1976	1,162.4	25.0	0.73	6.1	392.0	15.8	0.63	5.6	22.0
1977	1,330.4	13.3	0.71	5.9	459.2	17.2	0.71	5.5	25.2
1978	1,500.3	12.8	0.76	5.8	523.0	14.0	0.77	5.5	28.0
1979	$1,692.1	12.8%	0.81%	5.7%	$ 579.0	10.6%	0.64%	5.6%	$32.6
1980	1,855.7	9.7	0.80	5.8	629.8	8.8	0.13	5.3	33.3
1981	2,029.1	9.3	0.76	5.8	664.2	5.5	(0.71)	4.3	28.4
1982	2,193.9	8.1	0.71	5.9	706.0	6.3	(0.68)	3.7	26.2
1983	2,342.0	6.7	0.66	6.0	771.7	9.3	0.24	4.0	30.9
1984	2,508.4	7.1	0.64	6.1	902.4	16.9	0.15	3.9	34.6
1985	2,730.4	8.9	0.70	6.2	1,070.0	5.5	0.27	4.3	41.3
1986	2,941.1	7.7	0.62	6.2	1,163.9	8.8	(0.13)	4.5	52.2
1987	3,000.0	2.0	0.12	6.0	1,251.4	7.5	(0.20)	3.7	46.4
Pre-Deregulation 1968 - 1978		11.8%	0.81%	5.8%		13.2%	0.66%	5.5%	
Post-Deregulation 1978 - 1987		8.0%	0.66%	6.0%		9.3%	(0.07)%	3.7%	
Change Since Deregulation		(3.8)%	(0.16)%	0.2%		(3.9)%	(0.73)%	(1.8)%	
Percentage Decline		(32.5)%	(19.2)%	3.4%		(29.2)%	(110.5)%	(33.1)%	

Memorandum:

Forgone Growth	$732.4	$ 141.8
Vs. Growth in Fixed Income Mutual Funds 1978 - 1987	$670.5	

1 - Total worldwide assets, domestic and foreign.
2 - All FSLIC insured S&Ls.
3 - Assets of NYSE broker dealers, excluding repurchase agreements and unregulated subsidiaries.
4 - FSLIC insured S&Ls held $201.0 billion of Agency MBS at year-end 1987, or 24.3% of total Agency sponsored mortgages.

Source: Corporate reports and Bernstein estimates.
(47/13,13A.)

Exhibit 4B

Financial Deregulation
The Winners

The Mutual Fund Industry			The Securities Industry				Federally Sponsored Mortgage Agencies: Fannie Mae, Freddie Mac, Ginnie Mae			
Total Mutual Funds	Annual Asset Growth	Total Fixed Income	Total Assets[3]	Annual Asset Growth	Net Worth ($ bil)	Net Worth Ratio	Total Agency[4]	Agency as % Total Mortgages	Annual Agency Growth	Agency Share Total Mtge. Growth
$ 48.3	(8.3)%	$ 1.8	na	na	na	na	na	na	na	na
47.6	(1.4)	2.1	na	na	na	na	$ 34.1	9.9%	na	na
55.0	15.5	2.5	na	na	na	na	41.2	10.7	$ 7.1	18.0%
59.8	8.7	2.5	na	na	na	na	47.2	10.8	6.0	11.2
46.5	(22.2)	2.1	na	na	na	na	57.0	11.7	9.8	19.1
36.5	(21.5)	4.2	na	na	na	na	72.6	13.7	15.6	39.4
45.9	25.8	5.9	$ 24.5	na	$ 2.9	11.8%	87.5	15.2	15.0	32.3
55.1	20.0	7.5	33.9	38.4%	3.1	9.1	101.2	15.7	13.7	20.1
47.3	(14.2)	9.7	35.4	4.4	3.2	9.0	123.0	16.5	21.8	20.8
53.5	13.1	16.7	40.0	13.0	3.4	8.5	151.1	17.4	28.1	23.8
$ 87.7	63.9%	$ 48.1	$ 48.9	22.2%	$ 4.0	8.2%	$200.6	19.4%	$ 49.5	33.0%
121.7	38.8	73.5	71.2	45.6	5.4	7.6	229.1	21.3	28.5	42.5
209.4	72.1	164.6	79.2	11.2	6.7	8.5	240.1	21.0	11.0	17.1
264.9	26.5	206.0	121.0	52.8	8.0	6.6	325.1	27.5	85.0	214.6
270.1	2.0	184.3	140.3	16.0	11.8	8.4	403.0	31.3	77.9	74.7
334.6	23.9	247.6	171.6	22.3	12.8	7.5	458.1	31.5	55.1	32.3
458.4	37.0	334.3	257.7	50.2	16.7	6.5	549.6	34.4	91.5	65.0
681.4	48.6	493.5	280.3	8.8	21.4	7.6	700.4	38.1	150.8	82.2
732.0	7.4	521.0	213.3	(23.9)	24.2	11.3	829.1	40.4	128.7	60.2
	1.5%			na				17.4%		23.8%
	35.6%			22.0%				40.4%		60.2%
	34.0%			na				23.0%		38.4%

Exhibit 5

Discretionary Liquid Financial Assets - Holdings At Year End ($ billion)[1]
(Households, Personal Trusts and Non-profit Organisations)

	Demand Deposits & Currency	Small Time & Savings Accounts					Fixed Income Mutual Funds	Credit Market Instruments[3]
		Credit Unions[2]	S&Ls	Savings Banks	Banks	Total Time & Savings		
1968	$112	$ 10	$132	$ 64	$160	$ 366	$ 2	$ 215
1969	109	13	135	67	166	381	2	248
1970	118	14	146	71	180	411	2	262
1971	130	16	173	81	209	479	3	253
1972	142	19	205	91	233	548	3	255
1973	151	22	224	95	246	587	2	304
1974	157	25	238	97	264	624	4	362
1975	163	29	280	108	304	721	6	364
1976	176	29	329	121	358	837	8	368
1977	193	38	377	131	386	932	10	411
1978	218	45	416	138	399	998	17	490
1979	250	48	441	140	429	1,058	48	589
1980	261	51	471	145	474	1,141	74	685
1981	294	52	475	147	514	1,188	165	722
1982	316	58	508	146	611	1,323	206	758
1983	342	63	574	154	742	1,533	184	823
1984	364	76	640	153	817	1,686	248	985
1985	388	99	685	149	897	1,830	334	1,108
1986	472	118	717	142	969	1,946	494	1,074
1987	482	125	766	131	996	2,018	522	1,252
Pre-Deregulation 1969 - 1978			12.2%	8.0%	9.6%	10.6%	23.9%	8.6%
Post-Deregulation 1978 - 1987			7.0	(0.1)	10.7	7.3	46.3	11.0
Impact of Deregulation			(5.2)%	(8.1)%	1.1%	(3.3)%	22.4%	2.4%

1 - Excludes non-discretionary contribution to pension and life insurance reserves, security credit and miscellaneous financial assets.
2 - Credit Union small time & savings are net of miscellaneous non-household holdings.
3 - Credit market instruments include large-time deposits at banks and thrifts.
4 - Equities are marked to market. Hence, bear market of 1970's and bull market of 1980's account for bulk of the differential in growth rate for this class of financial assets.

Source: Federal Reserve Board Flow of Funds and Bernstein estimates.
(46/3,3A.)

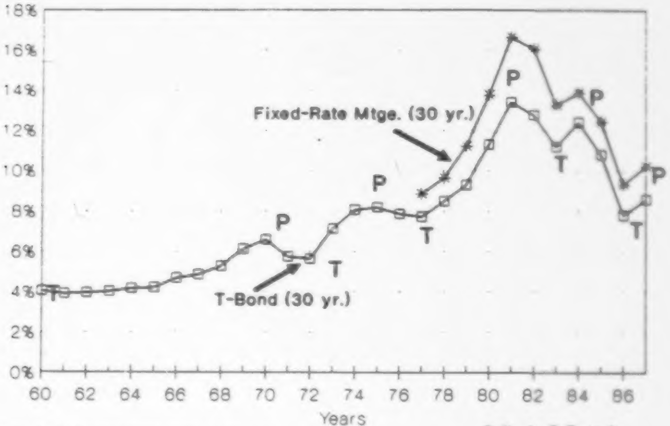
Exhibit 5 (Continued)

Deposits & Credit Mkt. Instruments	Corporate Equities[4]			Total Discretionary Liquid Financial Assets	Share of Household Liquid Financial Assets	
	Direct Investment	Mutual Funds	Total Equities		Time & Savings	Fixed Inc. Funds
$ 695	$ 807	$ 46	$ 853	$1,548	23.7%	0.1%
740	699	47	746	1,485	25.7	0.1
793	683	46	729	1,522	27.0	0.1
865	778	53	831	1,695	28.3	0.1
948	862	57	919	1,867	29.4	0.1
1,044	664	44	708	1,752	33.5	0.1
1,147	460	32	492	1,639	38.1	0.3
1,254	599	40	639	1,893	38.1	0.3
1,389	713	48	761	2,150	38.9	0.3
1,546	669	38	707	2,252	41.4	0.4
1,723	664	37	701	2,424	41.2	0.7
1,945	812	40	852	2,797	37.8	1.7
2,141	1,111	48	1,159	3,300	34.6	2.2
2,369	1,051	45	1,096	3,464	34.3	4.8
2,603	1,173	59	1,232	3,835	34.5	5.4
2,882	1,323	86	1,409	4,291	35.7	4.3
3,283	1,323	87	1,410	4,693	35.9	5.3
3,660	1,685	124	1,809	5,469	33.5	6.1
3,986	1,851	188	2,039	6,025	32.3	8.2
4,274	1,698	210	1,908	6,182	32.6	8.4
9.5%			(1.9)%	4.6%	41.2%	0.7%
10.6			11.8	11.0	32.6	8.4
1.1%			13.7%	6.4%	-8.5%	7.8%

Exhibit 6

LONG TERM RATES

Annual Averages



Source: FHLBB and Bernstein estimates.

P-Peak, T-Trough

Exhibit 7

Measures of Financial Health

	GAAP Capital to Liabilities at June 30, 1988					Weakest Third	Strongest Two Thirds
	Under 0%	0%-3%	3%-6%	Over 6%	Total	Under 3%	Over 3%
Total Assets	$188.0	$219.0	$548.0	$335.0	$1,290.0	$407.0	$883.0
% of Industry Assets	14.6%	17.0%	42.5%	26.0%	100.0%	31.6%	68.4%
Number of Institutions	495	394	870	1,333	3,092	889	2,203
% Profitable	14.3%	57.1%	78.5%	90.6%	70.7%	33.3%	85.8%
Number Profitable	71	225	683	1,208	2,186	296	1,891
Regulatory Capital	$(22.1)	$ 6.7	$ 27.8	$ 29.3	$ 41.7	$(15.4)	$ 57.1
RAAP Capital Ratio	(11.8)%	3.1%	5.1%	8.8%	3.2%	(3.8)%	6.5%
Est. GAAP Capital	$(26.1)	$ 4.0	$ 24.4	$ 27.7	$ 29.9	$(22.1)	$ 52.1
GAAP Capital Ratio	(13.9)%	1.9%	4.4%	8.3%	2.3%	(5.4)%	5.9%
Intangibles (primarily goodwill)	$4.7	$ 5.6	$ 10.5	$ 6.3	$ 27.0	$ 10.3	$ 16.7
Est. Tangible GAAP Capital	$(30.8)	$ (1.6)	$ 13.9	$ 21.4	$ 2.9	$(32.4)	$ 35.3
GAAP Capital Ratio	(16.4)%	(0.7)%	2.5%	5.4%	0.2%	(8.0)%	4.0%
Interest Free Funds	$(56.1)	$(16.5)	$(11.7)	$ 6.7	$ (78.6)	$(72.6)	$ (5.0)
% Int. Earn. Assets	(37.2)%	(8.6)%	(2.4)%	2.2%	(6.8)%	(21.1)%	(0.6)%
Net Income (annualized)	$(18.3)	$ (1.0)	$ 2.4	$ 2.1	$ (14.8)	$(19.3)	$ 4.5
Core Net Income (Annualized)	$(18.6)	$ (1.5)	$ 1.5	$ 1.6	$ (14.8)	$(20.1)	$ 3.2
ROA	(9.83)%	(0.46)%	0.44%	0.62%	(1.16)%	(4.79)%	0.51%
Foreclosed Assets Net of Val. Allow.	$ 17.5	$ 3.4	$ 3.6	$ 1.9	$ 26.3	$ 20.9	$ 5.5
As % Assets	9.3%	1.6%	0.7%	0.6%	2.0%	5.1%	0.6%

Source: Corporate reports and Bernstein estimates.
(48/5)

Exhibit 8

U.S. Thrift Industry (All FSLIC Insured Institutions)
Functional Income Statement by GAAP Capital Ratios: 2Q88
Pretax Margin as Percent Interest Earning Assets ($ billion)

	GAAP Capital to Liabilities at June 30, 1988				
	Under 0%	0%-3%	3%-6%	Over 6%	Total
Accretion of Purchase Discount	na	na	na	na	0.05%
Net Interest Income	na	na	na	na	1.55
Subtotal	(1.36)%	1.40%	1.92%	2.56%	1.60%
Loan Fees	0.10%	0.18%	0.17%	0.16%	0.16%
Service Charges & Other Fees	0.24	0.33	0.29	0.22	0.27
Subtotal	0.35%	0.51%	0.46%	0.38%	0.43%
Other Income	(0.40)%	0.28%	0.25%	0.35%	0.19%
Gains on Sales of:					
Loans & Secs.	(0.02)%	0.09%	0.23%	0.05%	0.12%
Real Estate	0.15	0.12	0.05	0.07	0.02
Subtotal	0.13%	0.21%	0.27%	0.12%	0.14%
Non-Interest Revenue	0.08%	1.00%	0.98%	0.84%	0.77%
G & A Expense	2.56%	2.06%	1.89%	1.97%	2.03%
Provision for Losses on Loans & REO	7.96	0.66	0.19	0.23	1.30
Amortization of Goodwill	0.18	0.13	0.09	0.09	0.11
Non-Interest Expense	10.71%	2.85%	2.18%	2.29%	3.45%
Pretax Margin	(11.99)%	(0.45)%	0.72%	1.11%	(1.07)%
Pretax Income	$ (4.5)	$ (0.2)	$ 0.9	$ 0.8	$ (3.0)
Net Income	$ (4.6)	$ (0.2)	$ 0.6	$ 0.5	$ (3.7)
Core Net Income[1]	$ (4.6)	$ (0.4)	$ 0.4	$ 0.4	$ (3.7)
Aftertax Margin	(12.28)%	(0.52)%	0.49%	0.68%	(1.31)%
Average Interest Earning Assets (IEA)	$ 149	$ 191	$ 493	$ 304	$1,136
Average Interest Costing Liabilities (ICL)	$ 205	$ 207	$ 505	$ 298	$1,214
Average Interest Free Liabilities (IFL)	$ (56)	$ (16)	$ (12)	$ 7	$ (78)
Average IFL as % Avg. IEA	(37.3)%	(8.6)%	(2.4)%	2.1%	(6.9)%

1 - Core net income is our definition of operating income. It excludes the effects of purchase accounting and asset sales.

Source. Federal Home Loan Bank Board and Bernstein estimates.
48/7)

Appendix

Why Financial Deregulation Magnifies the Interest Rate Cycle

Deregulation's attempt to insulate housing has merely raised the interest rate threshold at which the inevitable downturn in housing occurs.

While restrictive credit policy is intended to dampen economic activity generally, the 20% of GNP which consists of federal, state and local government spending is, not surprisingly, unaffected by increases in interest rates. Personal consumption expenditures for services and non-durable goods account for 33% and 23% of GNP respectively, and as Exhibits 9A and B and 10A and B show, have been virtually undisturbed by rising rates over the past six business cycles. Exhibit 9A, for example, presents the behaviour of consumer services during the four quarters preceding, and during the four quarters following, peaks in interest rates that have been followed either by frank recessions or economic slowdowns. Exhibit 9B also presents the behaviour of the service sector, but examines its behaviour around the peak in GNP, which has preceded the peak in rates by roughly one quarter. These sectors together account for 76% of GNP.

This leaves capital spending which comprises 12% of GNP, personal consumption of durable goods at 10%, residential construction at 5%, net exports which currently represent (3)%, and changes in business inventories which average 1% of GNP.

Capital spending has on average in the six cycles since the Korean war been a coincident indicator, peaking with GNP, and turning down late in the interest rate cycle (see Exhibits 11A and B). Capital spending is a function of the rate of capacity utilization. Businessmen will spend to increase productive capacity as long as they can sell the incremental output. Once final demand softens, so does capital investment, as there is no reason to add to capacity when existing capacity becomes idle.

Consumer durables have registered some declines on average in the rising rate period preceding a peaking in GNP, but this reflects the fact that we had explosions in gasoline prices in two of these cycles that precipitated automobile downturns. These non-rate related auto declines, in conjunction with the drop in furniture and appliances that is merely a ripple effect of the housing decline, create the appearance of greater interest rate sensitivity for durables than actually exists. And even so, the average decline in consumer durables in the face of soaring interest rates has been quite small (see Exhibits 12A and B).

The principal impact on the real sector of the economy has always been delivered through sharp contractions in housing. For example, while it represents just 5% of GNP, peak to trough declines in residential construction expenditures have equalled 55% of the GNP declines in our past six recessions. Thus one of the goals of deregulation was to spread the effects of monetary restraint over a broad spectrum of economic activity. Unfortunately, there is little evidence that major sectors of the economy other than housing are at all sensitive to interest rate increases.

Residential construction has, of course, shown dramatic sensitivity to rising interest rates as major declines have preceded all of the past six recessions (see Exhibits 13A and B and Exhibits 14A and B).

Historically, the effect of Regulation Q ceilings during high interest rate periods was to impose a cash flow squeeze on the housing sector at a predetermined threshold level for rates, about 150 to 200 basis points above the deposit ceilings. Today depositories bid up for funds, basis point for basis point with the open market, until the home borrower gags on the mortgage rate, even though credit remains available. As rates rise, the perception is strengthened at thrifts that rates will continue to rise, and they shift their lending mix to ARMs by offering deep teaser rates. The effect of shifting the mix from 65% fixed rate and 35% adjustable rate mortgages in low rate environments, to the reverse in high rate environments, is to mute the effects of restrictive monetary policy by limiting the rise in the weighted average cost of mortgage credit.

The effect of a 300 basis point rise in short rates and a 200 basis point rise in long rates produces only a 140 basis point rise in the weighted average rate on loans closed, given the mix shift described above. If the T-Bill goes from 6% to 9%, the fixed-rate mortgage from 11% to 13%, and the ARM from 9% to 11%, the weighted average rate would rise from 10.30% to just 11.70%. This is essentially what took place in 1984.

For example, from the spring lows of 1983 to the autumn highs of 1984, 3-month T-Bills rose by 332 basis points, from 7.80% to 11.12%, and the long bond rose 367 basis points, from 10.27% to 13.94%. This was the second highest level for nominal interest rates in our history, and the highest real interest rate in our history. Yet we had no recession. In fact, the slowest GNP quarter was 2%, and GNP averaged 6.8% for the year as a whole, and grew at 3.4% the following year.

Housing starts fell from 1.80 to 1.63 million between third quarter 1983 and fourth quarter 1984, a mere 10% decline. Savings flows at thrifts actually rose from an 11.6% growth rate to a 14.0% rate of growth over the same period, and mortgage lending seasonally adjusted was virtually unchanged at roughly $24 of new loans closed per $100 of loans in portfolio (SAAR) for the thrift industry.

In the absence of restrictive fiscal policy, (we haven't had a budget surplus since the fourth quarter of 1969), the job of combating price inflation by precipitating periodic recessions that idle labor and capital resources will be left to monetary policy. If housing is the principal rate sensitive sector, and deregulation has loosened the FRB's ability to shut down the housing sector within an extraordinarily wide range of rates, the implication is that we will have megadoses of rates, whatever it takes, to finally hit housing. This seems to be the legacy of deregulation.*

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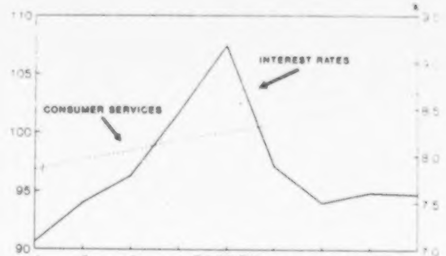
* - The notion that rising monthly payments on ARMs might lead to an interest rate induced decline in consumer spending as consumers would have less of their pay checks to spend in the department store, because they would be mailing more to the bank, seems unlikely when one examines the arithmetic. There are perhaps $700 billion of ARMSs outstanding. Assuming the maximum 200 basis point rise, the impact would be $14 billion pretax, $10 billion net. Consumer spending is over $3.0 trillion. The order of magnitude needed to send the economy into recession is at least 1.5% of GNP, or $75 billion (500,000 housing starts at $110,000 per, within six months would do the trick, i.e., $110 billion at an annual rate). Moreover, increasing interest receipts on over $2.0 trillion of deregulated deposits would be three times the negative impact of the ARM.

Exhibit 9A
INTEREST RATES AND CONSUMER SERVICES
(average of nine post-Korean War cycles)



The proxy for interest rates is an average of Aa utility bond and commercial paper rates

Exhibit 9B
GNP AND CONSUMER SERVICES
(average of six post-Korean War cycles)

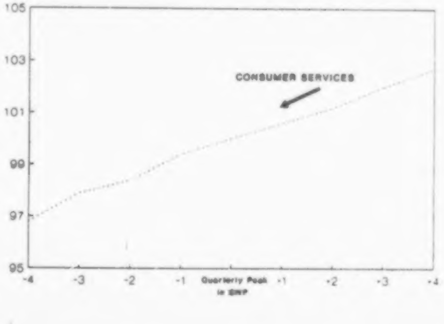
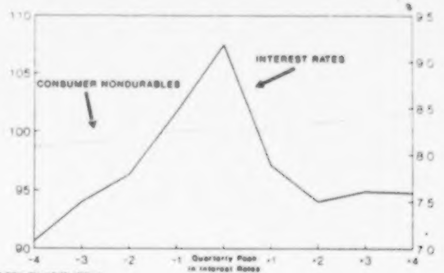


Exhibit 10A
INTEREST RATES AND CONSUMER NONDURABLES
(average of nine post-Korean War cycles)



The proxy for interest rates is an average of Aa utility bond and commercial paper rates

Exhibit 10B
GNP AND CONSUMER NONDURABLES
(average of six post-Korean War cycles)

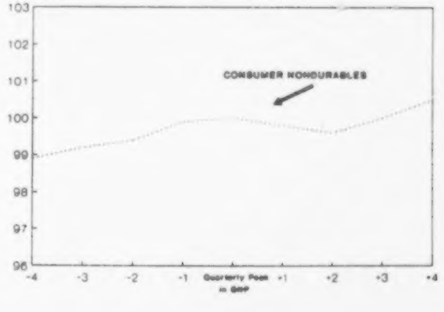
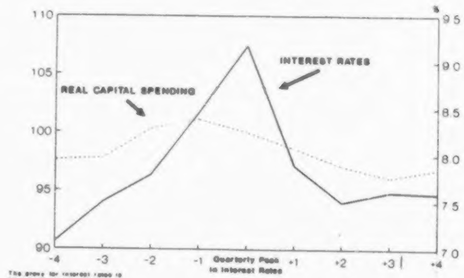


Exhibit 11A
INTEREST RATES AND REAL CAPITAL SPENDING
(average of nine post-Korean War cycles)



The proxy for interest rates is an average of Aa utility bond and commercial paper rates

Exhibit 11B
GNP AND CAPITAL SPENDING
(average of six post-Korean War cycles)

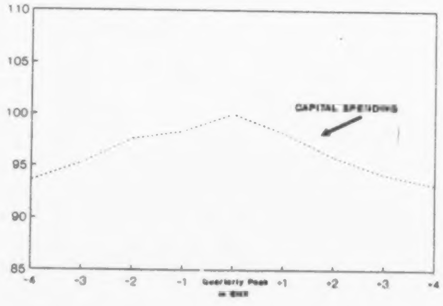
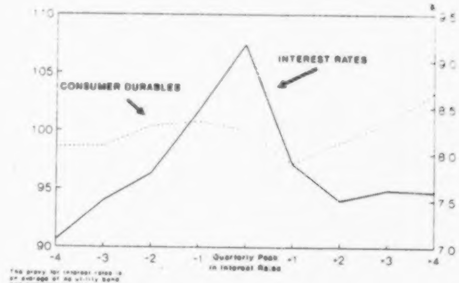


Exhibit 12A
INTEREST RATES AND CONSUMER DURABLES
(average of nine post-Korean War cycles)



The proxy for interest rates is an average of Aa utility bond and commercial paper rates

Exhibit 12B
GNP AND CONSUMER DURABLES
(average of six post-Korean War cycles)

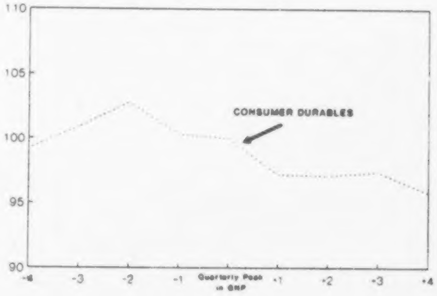
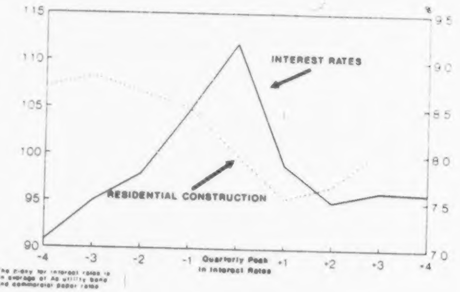


Exhibit 13A
INTEREST RATES AND REAL RESID. CONSTR.
(average of nine post-Korean War cycles)



The proxy for interest rates is an average of Aa utility bond and commercial paper rates

Exhibit 13B
GNP AND RESIDENTIAL CONSTRUCTION
(average of six post-Korean War cycles)

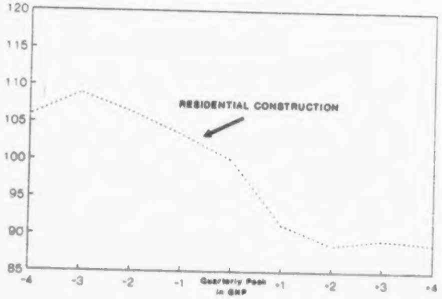
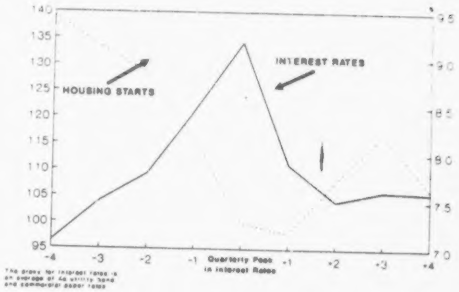
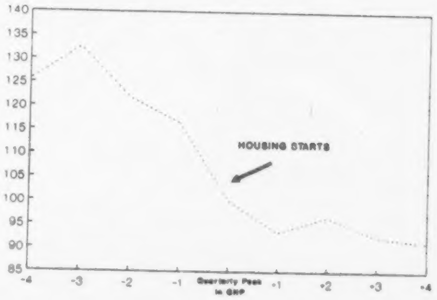


Exhibit 14A
INTEREST RATES AND HOUSING STARTS (SAAR)
(average of nine post-Korean War cycles)



The proxy for interest rates is an average of Aa utility bond and commercial paper rates

Exhibit 14B
GNP AND HOUSING STARTS (SAAR)
(average of six post-Korean War cycles)



The CHAIRMAN. Thank you very much. We appreciate the summary and the full testimony.

Mr. Koch, we'd like to hear from you now.

STATEMENT OF CHARLES JOHN KOCH, CHAIRMAN, NATIONAL COUNCIL OF SAVINGS INSTITUTIONS, PRESIDENT AND CEO, CHARTER ONE FINANCIAL, CLEVELAND, OH

Mr. KOCH. Thank you, Mr. Chairman. I appreciate the opportunity to speak with you today. I am president and chief executive officer of Charter One Financial, a federally chartered unitary savings and loan holding company in Cleveland, OH. I might point out that we have a GAAP net worth of 7.3 percent and in 1988 we returned .82 percent on assets. We did that because we have fully utilized the powers granted under Garn-St Germain to Federal savings banks and that quite frankly is what is keeping us profitable in the environment of 1989.

I am here today in my capacity as chairman of the National Council of Savings Institutions. The National Council represents 500 institutions nationwide with $550 billion in assets; 70 percent of our members are FDIC insured, but FSLIC insured institutions represent over 50 percent of our asset base. On average, our member institutions have a GAAP net worth of 6 percent.

The National Council supports the administration's plan as a foundation for the solution to the problems caused by the large number of insolvent institutions.

Considering the condition of the industry, the costs imposed on the industry by the many provisions of this bill and the current economic environment, the National Council believes, however, that the funding proposal and the economic assumptions underlying the bill raise several critical issues that need to be examined more closely.

Moreover, as the committee examines various elements of the bill, the National Council believes that it is essential to keep in mind the need to attract private capital into the savings and loan industry if the expenditures to the taxpayer is to be kept to the minimum.

S. 413 provides a broad-based regulatory reform with the Federal Home Loan Bank Board coming under Treasury oversight, equalization of capital standards for all institutions, depository insurance mechanisms under the responsibility of a single agency. The proposal also calls for more rigorous enforcement and stiffer criminal penalties, provisions that the National Council strongly supports.

Our own proposal issued last December is consistent with the proposal calling for improved capital standards and rigorous supervisory and enforcement powers. We support early intervention policies which would help to minimize future public expenditures.

We also endorse the separation of the FSLIC from the Federal Home Loan Bank Board, the future role of the FDIC as administrator of both insurance funds, and the acquisition enhancements included in the proposal. These enhancements were part of a package introduced in S. 2073 in the last Congress and is strongly endorsed by the National Council.

Further, the National Council supports provisions that will allow bank holding companies to purchase healthy thrifts. This will assist the flow of capital into the industry. The 2-year delay contained in the bill should be removed and we should allow these acquisitions to proceed as quickly as possible.

The National Council supports the overall regulatory reform, but the funding proposal and the economic assumptions underlying the plan cause us great concern.

There are only three sources of funds, Mr. Chairman, to solve this problem. One is the savings industry. Two is the taxpayer. And three is the private capital markets.

At the one end, the industry, through higher deposit insurance premiums and the use of all current retained and perhaps even all future earnings of the Federal Home Loan Bank System is being forced to pay what is most likely more than it can afford.

At the other end, the taxpayer will be required to pick up the remaining costs.

However, between these two extremes lie the capital markets, that pool of well-capitalized investors who must be provided with realistic incentives to invest their capital in these institutions. These are voluntary contributors who must be encouraged to invest in and take control of failing savings institutions.

To the extent that the provisions of this bill cause viable savings institutions to deteriorate, the cost to the taxpayer will be higher. To the extent the provisions of the bill provide disincentives to the capital market investors, the cost to the taxpayer will be higher.

The way to lower the cost to the taxpayer and ensure the success of the program is to provide incentives, not disincentives, for the inflow of private capital into the industry.

There are at least five provisions in the bill that discourage private capital and increase the ultimate cost to the taxpayer.

The first and most important is the ongoing differential in insurance premium assessments which is anticipated well into the future for the industry. As a result of that differential, we have a need for a 5-year moratorium on the free movement between the insurance funds. The bill anticipates imposing entrance and exit fees between the movements of the two funds. There is a heavy burden of the insurance premiums that we mentioned. And last, and fifth, the financial demands placed on the Federal Home Loan Bank System will result in substantially reduced dividends to member institutions and a potential devaluation of the Federal Home Loan Bank stock held by these institutions.

This burden on the Federal Home Loan Bank System would provide strong disincentives for further use of the Federal Home Loan Bank advances by member institutions.

Eliminating or at least minimizing the above mentioned burdens would go a long way toward encouraging private capital into the system.

With regard to the previous points, the National Council strongly believes that there should be free movement between insurance funds. At a minimum, however, there should be a common logo and sticker signifying the backing of the Federal Government.

With regard to the FDIC's authority to raise premiums, the National Council recommends that the FDIC give Congress not less than 6 months advance notice whenever a proposed increase deposit insurance premiums.

Under the bill the Federal Home Loan Bank System is called upon to contribute to the repairing of FSLIC insolvency in a number of ways. If left unchanged in the administration's proposal, these provisions will erode industry capital at the very time the industry will need to attract new capital in order to resolve this current problem.

The legislation may significantly reduce the value of the industry's stock in the system of the Federal Home Loan Banks.

The National Council has supported and long advocated the equalization of capital standards for all insured depository institutions. Our own proposal issued last December is consistent with the administration's proposal in suggesting a 6 percent GAAP standard. Unfortunately, the time table established in the bill of June 1, 1991 is totally unrealistic in light of the current market environment. Quite simply, it is impossible for most of those institutions to meet capital standards in the time table in which it is being requested.

The bill requires recapitalization of solvent institutions but seriously impairs their internal sources for accomplishing this capitalization and increases premium payments and reduces the dividends from and erodes the capital value of member institutions' stock holdings in the Federal Home Loan Bank System and significantly accelerates the amortization of good will currently included as an asset.

We would recommend a 5-year capital phase-in as a more realistic approach with close scrutiny and growth limitations while these institutions get to their required capital mandate.

The bill requires investments in certain subsidiaries to be deducted from the institution's capital. The National Council supports the logic underlying this provision, however believes that the comparison standard for determining permissible thrift activities should be based on the Federal thrift charter as opposed to the national bank charter.

Last, the National Council has great concern about the economic assumptions underlying the bill and, if incorrect, they seriously mislead Congress as to the ultimate cost of the proposal. Interest rate assumptions call for sharply declining long-term interest rates. If this assumption fails to materialize, the costs will grow.

The assumption about FSLIC-insured institutions with deposit base growing at 7.2 percent is totally unrealistic. Based on current levels of deposits of about one trillion dollars, this means that the proposal assumes a deposit growth of $70 billion per year. In light of the impact of the other provisions of the plan, namely the liquidation of 432 GAAP insolvent institutions and the fact that a large number of FSLIC-insured GAAP solvent institutions will have to shrink, not grow, to meet capital requirements, the growth assumption is totally unrealistic.

The industry's deposit base in point will be much smaller in the future, not larger.

In concluding, let me reiterate that the National Council supports the administration's plan as a foundation to a solution of the problem caused by the large number of insolvent institutions. We urge Congress to consider and adopt the improvements we have suggested in order to make the plan more workable and enhance the likelihood of achieving its desired goals.

Thank you.

[The complete prepared statement of John Koch follows:]

Statement of

Charles John "Bud" Koch

on behalf of the
National Council of Savings Institutions

before the

Committee on Banking, Housing, and Urban Affairs
of the
United States Senate

on

Financial Institutions Reform, Recovery
and Enforcement Act of 1989

March 7, 1989

Mr. Chairman, thank you for the opportunity to appear today. My name is Bud Koch and I am President and Chief Executive Officer of Charter One Financial, Incorporated, a federally chartered, unitary savings and loan holding company in Cleveland, Ohio. I am here today in my capacity as Chairman of the National Council of Savings Institutions.

The National Council of Savings Institutions represents 500 member institutions nationwide, with $550 billion in assets. While 70 percent of our members are FDIC-insured, FSLIC-insured institutions represent slightly more than 50 percent of member assets. Our member institutions have an average GAAP-capital ratio of 6 percent.

The urgent problems of a bankrupt insurance fund and a subsector of the industry that can best be described as "hopelessly insolvent" require the immediate attention of the Congress. Firm action must be taken soon to forestall further growth of the problem. If decisive action is not taken in the near term, it will jeopardize even further the viability of the surviving savings institutions -- institutions that provide essential financial services to this Nation's consumers.

The National Council supports the Administration's plan as the foundation for a solution to the problems caused by the large number of insolvent institutions.

Before I address the specific questions raised in your letter of invitation, let me take a moment to present a snapshot of the industry. There are really three general classes of institutions today. Based on data as of the end of last September, there were 1,419 institutions with $379 billion in assets that had capital-to-asset ratios above 5 1/2 percent on the basis of generally accepted accounting principles (GAAP). These institutions earned over $630 million in the third quarter of last year -- an annual return on assets of 68 basis points.

At the other extreme, 432 institutions with $138 billion in assets were insolvent and lost over $2.4 billion in the third quarter of last year -- an annual loss ratio of 704 basis points.

Between these two extremes, there were 1,173 institutions with $807 billion in assets. These institutions, which are currently solvent but with capital-to-asset ratios below 5 1/2 percent, earned only $7 million in last year's third quarter -- an annualized return on assets of "0" basis points.

These figures leave a broad range for estimating the true size of the problem. The ultimate cost will depend on a number of factors, including economic conditions, recovery values on real estate assets, and the method used for disposing of failed institutions. Most current estimates place the size of the problem at upwards of $100 billion.

Considering the condition of the industry, the current economic environment, and the costs imposed on the industry due to higher insurance premiums and the reduction in dividends on Federal Home Loan Bank stock, the National Council is concerned that the economic assumptions underlying this proposal may prove to be invalid. As the Committee examines the various elements of this bill, the National Council believes it is essential to keep in mind the need to attract additional private capital into the savings and loan industry if the expenditure of taxpayer funds is to be kept to a minimum.

With the introduction of S. 413, the Administration has proposed a comprehensive plan that addresses the problems presented by insolvent institutions, provides for regulatory reform, and suggests a funding mechanism that spreads the costs among several sectors. The plan is neither perfect nor painless, but the sheer size of the problem assures that no such solution exists. Further delay will only increase the costs and allow the problem to grow. The National Council urges the Congress to pass comprehensive legislation as soon as possible so that we can begin the process of putting this problem behind us.

REGULATORY REFORM

The bill provides for broad-based regulatory reform with the Federal Home Loan Bank Board coming under Treasury oversight, the equalization of capital standards for all insured depository institutions, and a depository insurance mechanism under the responsibility of a single agency. The proposal also calls for more vigorous enforcement, stiffer criminal penalties, and enhancement of thrift acquisitions -- provisions which the National Council strongly supports.

Our own proposal, issued last December, is consistent with the Administration's proposal in calling for improved capital standards and rigorous supervision and enforcement. We support the early intervention policies, which are designed to minimize, if not eliminate, the expenditure of public funds. We also endorse the separation of the FSLIC from the Federal Home Loan Bank Board, the future role of the FDIC as administrator of both insurance funds, and the acquisition enhancements included in the proposal. These acquisition enhancements were part of a broader package introduced as S. 2073 in the last Congress and endorsed by the National Council.

Allowing bank holding companies to purchase healthy thrifts will assist the flow of capital into the savings industry. The National Council supports this part of the

proposal. The two-year delay contained in the bill should be removed, however, in order to encourage the infusion of new private capital into the savings and loan industry as quickly as possible.

The National Council also supports the provision in the bill that amends the manner in which credit unions expense their contribution to their insurance fund.

FUNDING PROPOSALS

While the National Council supports the overall regulatory reforms, the funding proposals and the economic assumptions of the plan raise several crucial issues that we believe need to be examined closely.

There are three distinct sources of funding identified in the bill: the savings industry, the private capital markets, and the taxpayer. At one end, with the higher insurance premiums and the use of all current retained earnings and a significant portion -- perhaps even all -- of the future earnings of the Federal Home Loan Bank System, the savings industry is being asked to pay what is likely to be more than it can afford. At the other extreme, the Treasury and the American taxpayer represent the residual pool that will be forced to pick up whatever is left.

Between these two extremes lie the capital markets -- the pool of well-capitalized investors who must be provided with realistic incentives to place their capital at risk. These are voluntary contributors who must be encouraged, but cannot be forced, to invest in and take control of savings and loan associations. If provisions in the bill discourage private investors, including healthy banks and thrifts, from investing in the industry, then the price to the taxpayer will be greater than otherwise needs to be the case.

DISINCENTIVES FOR POTENTIAL INVESTORS

The provisions of the bill that discourage private capital and increase the ultimate cost to the taxpayer are as follows:

- the five-year moratorium on free movement between the insurance funds;
- the imposition of both exit and entrance fees;

- the heavy burden of deposit insurance premiums;
- the on-going differential in insurance premium assessments; and
- the financial demands placed on the Federal Home Loan Bank (FHLB) System resulting in substantially reduced dividends to member institutions and the potential devaluation of FHLB stock held by these institutions.

Eliminating or reducing these burdens will go a long way toward encouraging the inflow of capital.

On two separate occasions in recent years, the Congress stated that the "full faith and credit" of the United States stands behind the deposit insurance funds. It is this unequivocal Government guarantee, rather than the financial reserves of the funds, which provides depositors with the necessary assurances that their deposits are safe. While the current proposal maintains an accounting distinction between the members of the respective funds in order to assess the members of each differently, continuing to maintain any further artificial distinctions between the members of each fund is a transparent facade that will only further discourage outside investments. In terms of public confidence in the safety of insured deposits, it is inherently inconsistent and troubling to the public to hear, on the one hand, that the full faith and credit of the U.S. Government stands behind all insured deposits, and, on the other hand, to be told that there are two separate insurance funds, one of which clearly is financially insolvent.

The National Council believes that, at a minimum, there should be a common logo or sticker signifying the backing of the Federal Government. Recent data suggest that solvent FSLIC-insured institutions pay more for deposits than their FDIC-insured counterparts. While there may be many explanations, one is clearly that FSLIC insurance is seen by the public as substandard. Use of a common sticker would go a long way toward avoiding the perception of second-class citizenship in the future and reducing the ultimate cost of the plan. While the common logo is an important first step, it is imperative that the final version of this bill lay the groundwork for an ultimate equalization of all aspects of the insurance mechanism, including the premiums charged and the capital and accounting rules that are applied to all insured depository institutions.

At a minimum, we suggest the Congress permit any institution meeting FDIC standards to leave the FSLIC fund but require the institution to make two separate insurance premium payments. The institution would pay the full Bank Insurance Fund (BIF) premium to that fund and the difference between the BIF assessment and the SAIF assessment to the Savings Association Insurance Fund.

If left unchanged, the treatment of the Federal Home Loan Bank System under the bill may significantly reduce the value of the industry's stock in the Federal Home Loan Banks. Also, it will erode industry capital at the very time that the industry will have to attract new capital in order to resolve its current problems. This stock represents a substantial portion of the capital of the thrift industry.

Stock in the Federal Home Loan Bank System is a cost of membership in the system. Every member must purchase stock equal to one percent of that institution's aggregate unpaid loan balances. In addition, an institution securing advances must purchase stock representing at least five percent of the total advances.

Under the bill, the Federal Home Loan Bank System is called upon to contribute to repairing the FSLIC insolvency in a number of ways. First, about $2 billion of existing retained earnings will be used to defease REFCORP bonds. This contribution is over and above approximately $1 billion already used to defease FICO debt. In making the combined contribution, the FHLB System will lose the future earnings on almost $3 billion of assets. That is, at today's interest rates, the System's earnings will be reduced by almost $300 million annually because of the loss of income on these assets. This loss represents almost 20 percent of the System's profits and is roughly equal to the System's annual contribution to reserves.

The National Council has supported this contribution, which has already been earmarked for the FSLIC problem with the passage of the Competitive Equality Banking Act of 1987. We believe that removal of the existing retained earning represents the prudent limit of Federal Home Loan Bank System contributions.

The bill, however, proposes to take an additional $300 million per year out of the remaining earnings of the FHLB System. The only way the System can make this additional payment is by reducing dividends sharply.

We are extremely concerned that the net effect of the provisions of S. 413 with respect to the Federal Home Loan Bank System will require a devaluation and subsequent write-down of member institutions' stock in the FHLB System, representing a serious dilution of the industry's capital base. This would ultimately raise the long-term cost of this plan to the taxpayer, and represents a risk that is beyond the ability of the Government to control. The capital markets and the accounting profession will decide ultimately on the value of Federal Home Loan Bank stock, and the early warning signs are not good.

While the National Council has always supported rigorous accounting standards and strong capital levels, the timetable established in the bill is unrealistic in light of current market conditions. The bill calls for all insured depository institutions to meet FDIC capital standards by June 1, 1991. Quite simply, it is impossible for most of these institutions to meet the capital standards timetable mandated by the bill, especially considering the fact that other provisions of the bill will reduce earnings and discourage outside capital. In addition, the Federal regulators do not have the human resources that would be necessary to close these institutions.

As of the end of the third quarter of 1988, there were 1,173 solvent institutions with $807 billion in assets that would not have met current FDIC standards. At current earnings levels, it would be virtually impossible for these institutions to earn enough capital to meet the standards in two years. Even with considerable asset shrinkage, as many as 700 of these institutions, with about $450 billion in assets, probably will not be in compliance by the cut-off date.

This bill requires recapitalization by solvent savings and loan associations but seriously impairs the internal resources for accomplishing this recapitalization. It increases insurance premium payments, reduces the dividends from and erodes the capital value of member institutions' stock holdings in the FHLB system, and significantly accelerates the amortization of goodwill currently included as an asset.

This last point is especially troubling. Goodwill largely was accumulated in the early 1980s by institutions acquiring problem institutions from the FSLIC. This goodwill was carried as an asset to be amortized or written down over 40 years. This procedure was encouraged by the Federal Home Loan Bank Board because it saved the FSLIC's cash resources. The accelerated amortization schedule in the bill will force solvent but capital-impaired institutions to amortize $1.1 billion more each year than the original schedule required. FSLIC commitments with respect to goodwill and other aspects of the assisted merger agreements must be honored, especially if other healthy institutions are expected to place their capital at risk by investing in resolution cases in the future.

The National Council strongly recommends a five-year phase-in to the new higher capital requirements. During the phase-in period, institutions making significant progress toward meeting their capital standards would be subject to close scrutiny, growth limitations, and business plan reviews to ensure satisfactory progress toward the prescribed capital goals.

This section of the bill also authorizes the Chairman of the FHLBS to establish new capital standards for savings institutions, and provides a deadline by which savings institutions must conform to these standards. Moreover, the section states that investments in certain subsidiaries must be deducted from the capital of the savings institution for purposes of determining the institution's capital adequacy. Specifically, this provision mandates that investments in, or loans to, a subsidiary engaged in activities that are impermissible activities for national banks must be deducted from the savings association's capital position.

The National Council supports the logic underlying this provision, but with one significant change: the comparison standards for determining which activities are permissible should be based on the federal thrift charter, as opposed to the national bank charter. Amending the provision in this respect will ensure against any potential inconsistencies. Furthermore, we believe that the specific details involving the capitalization of such subsidiaries are best left to the Federal regulatory agencies, which are uniquely positioned in this bill to determine any and all standards needed to create a safe and sound banking system.

The bill allows the Chairman of the FDIC to raise premiums 50 percent per year up to a maximum of 35 basis points. While the National Council recognizes the need to provide an adequate resource stream to the insurance fund, the current proposal provides for no advance notice or oversight. The National Council recommends that the Congress be given not less than six months advance notice of any proposed increase.

With respect to the Federal Home Loan Mortgage Corporation (Freddie Mac) Board, the bill recommends changing the current Board composition to one that is comprised of the Chairman of the new Federal Home Loan Bank System, the Secretary of the Treasury, and the Secretary of HUD. The National Council supports placing Freddie Mac under the control of a shareholder-elected board of directors, but maintaining government agency status similar to that of the Federal National Mortgage Association (Fannie Mae). Fannie Mae's Board is comprised of 13 stockholder-elected members and five Presidential appointees, and has been an effective organizational structure.

ECONOMIC ASSUMPTIONS

The economic assumptions underlying the proposal are too optimistic with respect to both the assumption on long-term interest rates and the deposit growth assumption.

The interest rate assumption calls for sharply declining long-term interest rates in the relatively near term. If this assumption fails to materialize, the cost of the problem will rise because financing costs will grow. We understand that the Administration is already analyzing alternative interest rate assumptions. We believe that in evaluating S. 413, it is essential that more realistic economic assumptions be used.

The assumption with regard to deposit growth raises even more concerns. The proposal assumes a 7.2 percent deposit growth based on the current level of deposits, of about $1 trillion. That is, the proposal assumes deposit growth of about $70 billion per year. During normal periods this growth would be considered quite modest -- it barely exceeds the amount of interest credited to deposit accounts. In the environment created by this plan, however, it is at best overly optimistic and at worst totally inconsistent with the provisions of the bill.

The bill calls for a resolution of all insolvent institutions. At the end of last September, the latest available data, there were $121 billion of deposits in these institutions. If these institutions are closed, these deposits will be dispersed across the entire financial system. Even if these institutions are merged, it is unlikely that FSLIC-insured institutions will be the acquirors. There is insufficient capital in the healthy part of the industry to absorb these deposits. Moreover, if these institutions are closed and FSLIC-insured depositors are paid off, it is highly unlikely that many of these account holders will re-deposit their Government-issued checks into another FSLIC-insured institution.

In addition to the insolvent sector, as of September 30, 1988, there were 1,173 institutions with $564 billion in deposits which would not have met the current capital standards. These institutions will come under growth limitations or prohibitions. That is, many savings and loans in this sector will have to shrink to meet capital standards, rather than expand through deposit growth.

That leaves the growth burden, if the 7.2 percent assumption is to be met, on 1,419 institutions with $288 billion in deposits as of September 30, 1988. To assume that these institutions can grow by $70 billion per year, and in addition offset the $121 billion loss in deposits at the failing institutions, would imply annual growth rates of 25 to 65 percent for this sector. Clearly, these growth rates are not achievable.

Quite simply, the industry does not have the capital to support the deposits that currently exist, let alone support a 7.2 percent annual deposit growth. The deposits of the industry are more likely to shrink in order for the institutions to reach capital standards, and as savings and loans shift from higher-cost SAIF-insured deposits to other sources of funds. If the growth assumptions turn out to be wrong, there will be an insufficient cash flow to the Savings Association Insurance Fund and the cost to the taxpayer will be greater. The five-year phase-in of new higher capital standards, under close government scrutiny of institutions working to reach the higher standards, would increase significantly the likelihood that the deposit flow assumptions could be achieved.

The funding proposal for the Resolution Trust Corporation (RTC) makes use of an off-budget government-sponsored enterprise called the Resolution Funding Corporation, or REFCORP. We share the growing concern that this corporation does not meet the requirements of an off-budget agency and perhaps should more properly be included as a government entity. The integrity of budget accounting aside, using the government-sponsored entity approach will increase the cost to the taxpayer over the more appropriate direct Treasury funding. Treasury borrows at lower rates than do government sponsored enterprises, and even a modest REFCORP differential of, for example, 25 basis points, would add $125 million per year to the annual taxpayer cost of the proposal.

Mr. Chairman, your letter of invitation also inquired about the need for, and viability of, a separate regulated thrift industry. If your question asks whether there will be specialized housing finance institutions in the future, the answer is yes. Institutions can and will choose to specialize in housing-oriented products. This specialization, however, should not be dictated by the government. Excessive government control failed to provide the needed flexibility prior to the high interest rate periods of the early 1980s and, in part, contributed to the current problem.

Today's financial institutions are operating in a highly competitive and innovative marketplace. While many institutions will choose to specialize in housing finance, many others will choose to be broader-based community- and consumer-oriented financial service institutions. Residential mortgages will be nly one of many financial options available from these savings nstitutions.

A return to restrictive regulation is not the answer, nor was deregulation without proper supervision. The goal must be to establish a safe and sound financial services industry where specialization responds to market demands.

In closing, let me reiterate that the National Council supports the Administration's plan as the foundation for a solution to the problems caused by the large number of insolvent institutions. The National Council urges the Congress to consider and adopt the improvements that we have suggested in order to make the plan more workable, enhance its likelihood of achieving the desired goals, and reduce the ultimate cost to the taxpayer.

Thank you. I would be happy to answer any of your questions.

The CHAIRMAN. Thank you very much, Mr. Koch.

Before we begin the questions I'm going to call on my colleagues who have arrived for any opening comments they want to make. Let me yield next to the chairman of the Budget Committee, Senator Sasser.

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you very much, Mr. Chairman. I want to compliment you for your leadership and energy in putting together this comprehensive set of hearings on the FSLIC crisis.

Mr. Chairman, I think as we look deeper into this and as the crisis unfolds, it's increasingly clear that the economic assumptions that underlie the President's plan are simply too optimistic and quite likely the ultimate cost of the solution is going to be greater than we presently anticipate.

But at the same time, I don't doubt the sincerity of the president and his advisers in putting forth this program and it is at long last a solution to the problem. If it ends up costing us more than we anticipate, then unhappily the Treasury is simply going to have to meet that cost.

But it is reassuring that perhaps we have a solution here that will be permanent and we won't have to revisit this issue later.

I think we all want to make sure there are controls on the spending and we want to make sure that the spending that's done here is done efficiently and effectively. In this regard, we don't need to be operating a long-term support system, in my judgment, for marginally capitalized institutions. We've been doing that and we simply cannot afford it any longer.

And we should maximize our returns by trying to sell the assets of insolvent thrifts just as quickly as possible. I don't think we ought to continue to spend taxpayers' money to keep assets off the market. Rather, we should be making money by putting those assets on the market. We need to act quickly and I know the chairman is acutely aware of that and has been moving this committee along at a rapid pace.

The FSLIC issue, like the bigger budget deficit issue, is one that we may be addressing at the eleventh hour and to a great extent the FSLIC and the deficit issues are intertwined.

Now the Treasury plan is structured with this mix of on budget and off budget financing so it will be possible to meet the statutory targets of Gramm-Rudman-Hollings for deficit reduction. No doubt it would be cheaper if we could eliminate the off budget financing, but to finance the plan entirely on budget would require an agreement between the Congress and the administration. That's going to be difficult to get. Moreover, this extra interest premium for the off budget bonding, 25 to 40 basis points, no doubt is wasteful. It is going to cost more. It's $125 million per year in extra cost, but when you lay that down against the fact that FSLIC is losing $1 billion per month, we come to a crossroads as to whether or not we should cut our losses, move fast, follow the administration plan, put it partly off budget, or continue to struggle and try to get it all on budget while realizing we're hemorrhaging at the rate of $1 billion per month.

I just offer those comments and observations, Mr. Chairman, when we try to figure out whether to go on budget or off budget here.

The CHAIRMAN. Thank you very much, Senator Sasser.

Senator Gramm.

OPENING STATEMENT OF SENATOR GRAMM

Senator GRAMM. Mr. Chairman, let me thank you. I want to join my voice with everybody else's to thank you for your leadership and the way that we have moved out front on this bill. I think we are making progress. I am hopeful that we will be able to write a bill that addresses the problem, whatever size it may be.

I think it is important that the administration's plan have all outlays and revenues on budget. That is now the case. The fact that the borrowing is off budget reflects the fact that somebody else is borrowing rather than the Federal taxpayer. I rejoice in that fact and don't want to see it changed.

Mr. Chairman, the only thing that can really derail our efforts to try to move ahead quickly with a bill will be if we have some of the old dogs and cats that have in the past been part of various banking bills, that ended up dying, surface as riders to this bill. I hope we can write this bill without having it burdened with the so-called "lifeline" banking and savings and loan services. I hope that people will remember that when we take these assets back, they belong to the taxpayer and that therefore giving them to the homeless, or to whatever other group might like to make a claim, simply imposes very heavy costs on the taxpayer. If we can debate the legitimate issues that affect the taxpayer and the savings and loan industry, then we're going to have our hands full. I hope that we can fight off, on a bipartisan basis, amendments that just don't have anything to do with dealing with the thrift problem or dealing with the solvency of the insurance fund.

We have plenty of time in the next 2 years to debate all these other issues. Mr. Chairman, I am encouraged by the progress we're making, and I thank you for your leadership.

The CHAIRMAN. Thank you, Senator Gramm.

Senator Dixon.

Senator DIXON. Mr. Chairman, I will place my statement in the record.

The CHAIRMAN. Without objection, so ordered.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee continues another week of its tightly scheduled hearings on the problems of the thrift industry. I look forward to hearing the testimony of the chairman of the National Council of Savings Institutions, Charles Koch, and the chairman and the vice chairman of the U.S. League of Savings Institutions, respectively, Barney Beeksma and Kenneth Seaton. It is important that the committee understand directly from those working in the thrift industry how the administration's recapitalization and regulatory reform proposal will affect thrift institutions.

The proposal asks thrifts to do three things simultaneously: Increase the premiums they pay; double their capital from 3 to 6 percent; and, amortize the goodwill on their balance sheets. These are all important objectives. It is also important, however, that we not send into insolvency too many thrifts which in time could meet these higher standards.

In resolving the thrift crisis we must establish rules that will prevent a reoccurence of current problems. One rule must be that thrifts hold more real capital, rather than phony capital. In establishing these new rules, it is important to recognize that there are limits on what the industry can afford and on the amount of capital it can raise. Ignoring those limits could lead to a second avalanche of insolvencies, which certainly would increase greatly the total cost to our taxpayers.

We have numerous important objectives in this legislation. Not the least is minimizing the burden on taxpayers by requiring, among other things, that savings and loans pay as much of the resolution's financing as possible. I hope that our witnesses today will shed some light on how realistically and optimally we can raise capital standards for thrifts, maximize their contribution to the resolution, and avoid unduly throwing too many thrifts into insolvency.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bond, who celebrated his birthday yesterday.

Senator BOND. Thank you very much, Mr. Chairman. I guess turning 50 is better than the alternative and it does give one a renewed sense of history to realize that one's life has extended back into history.

I will forego further comments other than to say that I certainly appreciate the fine statements made by my colleague from Tennessee and my colleague from Texas. It does seem that if the fire department is on the way to put out a three-block fire that's raging in the city, to tell the fire department to stop and prepare to serve the needy and the homeless is likely to cause the conflagration to grow larger and impose more burdens and I would hope that we would heed Senator Gramm's comments.

I look forward to the testimony of the witnesses today.

The CHAIRMAN. Very good. Thank you.

Senator Sarbanes.

Senator SARBANES. Mr. Chairman, I have no statement. I just want to wish Senator Bond a happy next half century. [Laughter.]

The CHAIRMAN. Senator Graham of Florida.

Senator GRAHAM. I also have no opening statement. Happy birthday, Kit.

The CHAIRMAN. Very good. Let us now start the questioning period and I'd like to pose this question to you.

As I reconstruct the problem, there are a lot of elements that contributed to the financial catastrophe. But I am very troubled about State powers that go beyond the Federal charter that are protected by Federal deposit insurance and therefore the Federal taxpayer.

I think the pattern of the buildup of this problem shows that the States, with what I consider to be the most excessive extension of power into riskier and riskier areas, have to a very major degree created the largest part of this problem.

I would like to know whether either of the associations present are prepared to take a position that we should line up across this country the charter that we give federally insured savings and loans so that it is the same State by State? Second, if the States in a given case want to go beyond that and add some other activity, should that be done separate and apart and not in any way be connected to the Federal deposit insurance system?

I'm wondering if either of you are prepared to take that position. Mr. Beeksma, let me start with you.

SHOULD FEDERAL CHARTER BE THE SAME THROUGHOUT THE NATION?

Mr. BEEKSMA. Mr. Chairman, let me respond to it this way rather than saying yes or no to the specific position.

I think what you call into question here is really the issue of States rights and if we address that as far as the thrifts are concerned, then we certainly have to address it as far as the entire financial structure is concerned.

But you raised a very valid point and it's been a matter of increasing concern to us as we go on.

Our position is and continues to be that we think it's appropriate the dual charter system survive—the State charters and Federal charters for thrift institutions and banks and all the others—that that survives in some form. But it is also absolutely essential that the Federal deposit insurance fund protect itself against excessive risks. In other words, the State legislatures should not have the license of granting authorities against which the fund cannot protect itself.

Our position is that we think that risk can be properly controlled by capital standards and that if there are certain States that have granted additional powers outside of that there ought to be very strict capital requirements on the part of the insurance fund that says before you can embark on those activities you have to have appropriate capital in place to do that. If you do not have that capital, you will not exercise those powers. That would be our position.

I think the alternative is to simply say the States should no longer be in the business of chartering financial institutions and we are not in accord with that approach. We think it can be regulated by capital standards and appropriate supervision.

The CHAIRMAN. Well, I'd just make a comment to you, and that is, regulators come and go. Sometimes you get a good one and sometimes you get a lousy one. We've had some, I think, poor ones in the recent history as it relates to the development of this problem and I just have to tell you that, as one Senator, I have very little interest in leaving that to the whim of a given regulator that can change today from tomorrow.

I don't for the life of me understand why someone, say, who runs a savings and loan in Oak Harbor, WA, as you do, wants to now be saddled with the very substantial increase in premium which you're facing in this proposal largely to pay for the exercise of those excessive State powers in the States where that problem is the worst. And the data shows that to be the case.

So you are facing a situation where you and the other savings and loan operators are going to be asked to pay a very heavy increased insurance fee with a very substantial part of it going to pay for precisely that excess.

I'm a little disappointed that I don't see a clearer sense from you on that problem and dealing with it in a definitive way where we're not at the risk of having a regulator or a shift in philosophy in the regulatory system that blows one way one day and a different way the next day.

Let me ask Mr. Koch his opinion on it.

Mr. Koch. Mr. Chairman, I'm afraid that I don't have a strong disagreement with my colleague over here. It's a very knotty problem of State powers and I am personally a federally chartered institution so it's a little more academic and I agree with your comments. However, times do change and in the 1970's and the early 1980's those States that had dual banking system that had State powers provided the financial institutions in this country with quite a bit of protection. It was really the States that started the movement to variable rate loans. It was the States that started the movement toward NOW accounts. So if you're going to rein those powers in and eliminate the dual banking system, we're going to pay a very heavy price somewhere down the road that may be detrimental.

If we had had ARM authority in the early 1980's—that is variable rate loan authority—we probably wouldn't be sitting here at this table today.

We think that there needs to be something done with the problem of giving a Federal Government blank checkbook to the State powers. We also think that the way to address that problem is private capital. If you have private capital in the institution, it presents a very, very strong restraint. I am much more concerned about squandering my shareholders' capital than I might be about costing the insurance company some money down the road and that private capital stands ahead of the insurance company. If an institution does not have private capital, I think the Federal regulators should have the power to rein him in and not let him exercise those powers. If he has the private capital, I think that we'll find that in most cases the State powers will be wisely exercised by the institution and tempered in the utilization of what they do.

The Chairman. I appreciate the detailed answers you've both given, but I want to take it down one more time to a very basic question. That is, the question of whether or not we should continue to allow Federal deposit insurance to stand underneath those State powers that go beyond what the Federal charter provides.

My view is that we should not and I've made that very clear. I gather that you are taking a position, Mr. Beeksma, that says that Federal deposit insurance should continue to be under those State powers that go beyond the Federal charter. Is that right? Or are you saying that you want to think about it more?

Mr. Beeksma. What I'm saying is that the insurance ought to extend to that type of activity provided there are proper constraints and capital requirements.

Mr. Chairman, let me amplify on my earlier comments and respond to your observations about——

The CHAIRMAN. Well, let me tell you something. We've got a lot of members here and my time is up and I'm very sensitive to try to stay within the limits.

Mr. BEEKSMA. This is very fundamental.

The CHAIRMAN. It is very fundamental and that's why the question of whether anybody is going to come in here and make the case that we ought to continue to put the Federal treasury—after we've lost $100 billion and maybe more—underneath State powers that can go all over the lot. That's fine as long as we've got a competent regulator in place, but, I think the record shows that in the past we have not always had competent regulators in place, and frankly, I think it's an insufficient answer and I think it undercuts your case.

Mr. BEEKSMA. My institution is a State charter. Were it not for the State charter and the powers in the State of Washington code, I very well could be one of those that FSLIC is now paying the costs for because we adopted an adjustable rate mortgage in 1969 and my institution has never lost money and I was able to do that because of the State charter.

So I am very concerned about preservation of that system because I think it works to the benefit of both sides. But I agree with you, Mr. Chairman, there has to be control of that activity. It's absolutely essential.

The CHAIRMAN. Mr. Koch, I want to see if I can get a clear answer from you, sort of a yes or no, as to whether or not we ought to keep that Federal deposit insurance in the future underneath those extended State powers.

Mr. KOCH. The administration proposal addresses the issue where I believe it is essentially moving those powers out of the depository insurance system by requiring 100 percent capital against those powers.

We support the administration's proposal in this area. We think that it needs a little bit of a look at in——

The CHAIRMAN. So that keeps the Federal deposit insurance under the State powers. Your answer again is, no, you don't think we should withdraw the Federal insurance from State-granted powers. That's the bottom line.

Mr. KOCH. That's not what I said. The administration is saying that they are withdrawing the insurance from those State powers because you have to have 100 percent capital in those subs and that would be subtracted from your net worth, so in effect you are not using deposit insurance for those powers.

The CHAIRMAN. I don't read it that way, but maybe we just have a difference of interpretation on that.

Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman.

Mr. Beeksma and Mr. Koch, each of you listed in your testimony a number of issues and problems you have with the administration's plan. At least 8, 10 or 12 provisions that you would like us to look at and change.

What are the two or three most important changes? I'd like you to prioritize them from the standpoint of each of your associations. Mr. Beeksma.

SOME CONCERNS WITH ADMINISTRATION PLAN

Mr. **Beeksma**. Well, from our perspective, the primary concern is in the area of costs to be assessed on our business.

Senator **Heinz**. That covers a lot of things. I understand that, but I would prefer that you give me a specific item. Is it the $300 million from the home loan banks? Is it the authority to go up to 35 basis points on deposits? Which one is it?

Mr. **Beeksma**. It's the combination of the two. When you add them together.

Senator **Heinz**. You only get one. Otherwise, it counts as two. What's your third one?

Mr. **Beeksma**. The independence of the Federal Home Loan Bank Board and the Federal Home Loan Bank regional banks as a separate system.

Senator **Heinz**. OK. Mr. Koch?

Mr. **Koch**. We really only have one and that is the provision in the bill which disincentivize private capital from coming into the system.

Senator **Heinz**. What is the provision in the bill?

Mr. **Koch**. The concern is the retardation of private capital.

Senator **Heinz**. We all understand that, but I'm trying to bring this down to cases. I've been here from the beginning. I've read your testimony. I've listened to your testimony. I understand it. Now I'm trying to ask you for some specificity in terms of individual specific proposals.

Mr. **Koch**. OK. The nut of the private capital problem is the fact that we don't see where there's ever going to be relative parity between the two insurance funds. The commercial bank fund will be in effect—the people in that fund will be paying much less for a very, very long extended period of time than the folks in the SAIF fund.

Senator **Heinz**. So you're worried about the differential in deposit insurance premiums.

Mr. **Koch**. That lack of relative parity will discourage private capital from coming into the system. We think it needs to be fixed to figure out a way around that.

Our suggestion would be that as institutions meet FDIC capital requirements—let's call it 6 percent GAAP capital—they should be admitted into the FDIC fund so that over time, say 4 or 5 years out in the future, you only have one fund. We are not calling for a merger of the fund. We are calling for a gradual movement into the fund as institutions are healthy.

Senator **Heinz**. Suppose that leaves some unhealthy institutions in the industry and we find that, for whatever reason, the taxpayers are left holding the bag once again now that the healthy institutions have gotten out of the FSLIC into the FDIC.

Mr. **Koch**. You would really only have three types of institutions. You have institutions that are already dead. They're insolvent and they should go to the RTC resolution—what's called the morgue for lack of a better word. You have healthy institutions that would be fully qualified from capital standards to be part of the FDIC fund. Any institutions in between the two we're suggesting a 5-year period to make that capital standard and at the end of

5 years they are either healthy or they should be merged out of existence. So over time you only have one or two types.

Senator HEINZ. I asked you a question and you gave me a great answer, but it wasn't to the question I asked. If everybody gets out of the FSLIC once they get to 6 percent capital, who's around to pick up the problem institutions? The answer is nobody except troubled institutions. You can see what we're stuck with there—a very large tab.

But let me ask you about the capital standards because both of you have raised the issue. You all seem to agree that the 1991 deadline for the capital standards can't be met by a large number of your thrifts.

Now I'm sure you also agree that one of the causes of today's problems is that thrifts with little—in some cases almost none of their own capital at risk—gambled with insured deposits and tried to grow their way to profitability.

Under the President's plan, a thrift that fails to meet its capital deadline will not be shot and put out of its misery. It will simply not be allowed to grow. It will not be allowed to gamble more insured deposits in order to attempt to grow its way to profitability.

What is wrong with that approach since it does seek to avoid something that caused the current problem. Mr. Beeksma, I think it was you that used the phrase "never again." This capital deadline is aimed at exactly preventing history from repeating itself. What is wrong with that approach?

Mr. BEEKSMA. Senator, I think conceptually you have a very good approach. I think what we're saying probably is that from a practical standpoint there are going to be a large number, probably a majority of those that ultimately will survive, that will not meet that standard by 1991. The question is, to what degree do we want to restrain those people from normal activities and growth. The projections on the premium flow are based on reasonable growth. What we're saying is if we want to be realistic about getting the majority of this group of institutions in compliance, it's going to take—I would agree with my colleague—in the neighborhood of 5 years.

Capital markets are not terribly attracted to the business today. It's going to take some time to build and attract that capital.

Theoretically, if we put it in place by 1991 and simply watch very closely those that don't make it, it would be difficult to argue with that. But from a practical standpoint, we think a longer timeframe would be easier to administer.

Senator HEINZ. You're simply saying please provide forbearance.

Mr. BEEKSMA. Not forbearance.

Senator HEINZ. That's what it seems to be to me. You're saying don't require everybody to be up there in 2 years, wait 5 years. That it seems to me is so close to the request we got in 1979, in 1981, in 1982, in 1985 or 1986, that it invites us to do something you say we shouldn't do, which is to, by ignoring the lessons of history, to relive it.

Now surely you've got to have a more refined response.

Mr. BEEKSMA. If you ask me do we want capital standards in accordance with the terms of the bill or no capital standards, we endorse capital standards. We think realism dictates we need to have a little longer time frame to get everybody in the fold.

Senator HEINZ. Let's say for some reason we agreed with you. Are you saying that we should have steps all the way along and anybody that doesn't make the step should be subject to the no-growth requirement? Is that what you're saying?

Mr. BEEKSMA. We call for steps, interim stages, with ultimate compliance at a future date.

Senator HEINZ. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Heinz.

Senator Wirth.

Senator WIRTH. Thank you very much, Mr. Chairman.

Just as a footnote to my earlier comment, you mentioned there had been a handful of scoundrels in this business. I think it's going to come out that there were probably more than that. We've heard testimony from the GAO that in 25 cases, fully all of the blame ought to go to fraud; and in 70 percent of the insolvencies fraud played some role. So I think just for the purposes of your protection I would suggest to you that you may want to look a little bit more broadly than just saying a handful of scoundrels because I think if the GAO numbers are correct we're looking at more than that.

Let me turn to a question I have which really builds on what Senator Riegle was asking about in terms of State powers.

It seems to me that fundamental to his very good question and discussion with you is the fact that we're looking at S&L's that have a different kind of a character. Some are federally insured depository institutions that have been very conservative and have done the job right and have carried out the long-term mission of the industry to provide loans to people who want to buy a house. As you correctly point out, some of the problems have been that those very legitimate operators who have done a very good job are being sullied by some of the high risk institution and some of the people who went down the chute by taking advantage of a system that was deregulated too rapidly and wasn't watched over.

Does that suggest to you that maybe we ought to move toward risk-based insurance, that those institutions that have a higher risk pay more than those institutions that have a lower risk, that those that are federally chartered perhaps have a lower risk than those that are State chartered?

What do you think?

RISK-BASED INSURANCE

Mr. BEEKSMA. Let me give you two answers to that, Senator.

The first is that the U.S. League's official position developed by our membership is that the risk factor can best be addressed by risk-based capital requirement rather than risk-based premiums. The reason for discounting risk-based premiums is the fact it's so difficult to administer and to judge who gets what premium. Theoretically, it has a lot of merit. I can personally tell you that I would favor a risk-based premium approach to many of the activities, but the official response I must give you is that that's determined——

Senator WIRTH. So the difference between making a risk-based premium and evaluating who pays the risk-based premium and who has the higher capital requirement if they have higher risks.

Mr. BEEKSMA. You can build a very strong case saying that there is no difference. That's why it's a difficult question.

Senator WIRTH. Then why does the League take a position that capital base can be risk based and premium insurance should not be?

Mr. BEEKSMA. Well, as I say, I think the question is the difficulty of administration and the arbitrariness of the judgments that would have to be made.

Senator WIRTH. What's the difference between the arbitrariness of the judgment if an institution has to have higher capital requirements or have a higher insurance premium? What's the difference?

Mr. BEEKSMA. Let me say, Senator, that if I were on a one-on-one with you I would agree with you, but let me defer to Ken who would like to respond to that.

Senator WIRTH. Wait a minute now. What's the League's position on that? Are we hearing a lowest common denominator approach from the League or are we hearing a very careful, honest analysis urged by the chairman early on?

Mr. BEEKSMA. We're saying you've identified a very important issue and that is how do we insulate the insurance fund from excessive risk.

Senator WIRTH. What you're telling us is that the League has one position but that really isn't a very valid position, that if we were having a little more analytic discussion we would look at it in a different way?

Mr. BEEKSMA. I'm not saying it's not a valid position. I'm saying it can be properly assessed in the capital requirements. That is our official position.

Senator WIRTH. I understand your position and you're telling us that you really can't make that distinction but that's the distinction that's been made by the League. Is that what I'm hearing? Do you want to try it, Mr. Seaton?

Mr. SEATON. Yes, please. The advantage of the risk-based capital is that if they do not have sufficient capital over and above the minimum they cannot get into some of these questionable activities.

Senator WIRTH. I understand the advantage of that.

Mr. SEATON. Well, what that does, if they don't have the capital they can't even get into the problems. If you have risk-based premiums they can get into these risky items, and the difficulty then is assessing a high enough premium in order to——

Senator WIRTH. I understand that. You start with high capital requirements and then you have higher insurance if you're going to be in the riskier operation. It seems to me that's a very logical thing for us to do to make sure that, in your words, Mr. Beeksma, this never happens again.

Mr. Koch.

Mr. KOCH. Senator, I think we agree with you and we support both risk-based premiums and risk-based capital requirements. We talked earlier about the State powers and somehow we need to find a way out of the box where we don't shut down the dual banking system and these kinds of ideas, where you put a significant cost out there for risky powers, I think is an excellent idea.

The concern we would have at this particular point in this bill would get a little bit to the fact that we need a bill very badly to get on with the resolution of these cases and I would be concerned that in developing the risk-based premiums it would delay the bill. But we strongly support that concept.

Senator WIRTH. That's a valid concern, but I think we ought to establish a concept and then figure out how to pursue it.

Just finally, for the record, could I get you all to give us your reactions of what safeguards ought to be built into the legislation for the RTC?

One of the concerns that I have and other people in areas like Colorado where there have been a lot of failures and the FSLIC owns a lot of property or FADA owns a lot of property, one of the things we ought to be concerned about is how do we safeguard against all of that property being dumped on the market. If that property gets dumped on the market, that in turn has an adverse effect on other property which in turn can spin out to a lot of other financial institutions and they go under water as well.

Should there be safeguards built into the legislation? Should there be safeguards built into the RTC so that this sort of thing doesn't happen?

Maybe, Mr. Chairman, we might get your recommendations for the record on that. My time has expired. I would like to have you discuss it but my time has expired.

The CHAIRMAN. Why don't you just make a brief comment if you wish and then give us the remainder in the record.

Mr. BEEKSMA. My observation, Senator, would be that we not place on the RTC any demands that they convert assets to cash too quickly. I think the danger is being forced to liquidate and further exacerbating the problem in certain markets.

Senator WIRTH. Exactly. How do we do that?

Mr. BEEKSMA. Not force a timeframe on these liquidations, allow proper judgments to be made by qualified people as this thing progresses.

Senator WIRTH. Should we build safeguards against it? You might get somebody down there who doesn't understand the situation in Dallas, TX or the situation in Aurora, CO and gets overeager and dumps property. Is there some kind of safeguard that can be built into that so that even with the discretion somebody doesn't operate in an imprudent fashion?

Mr. BEEKSMA. Perhaps I should defer to my friend, Ken Rosen, who is representing such a qualified institution out in California. Maybe he has an observation.

Mr. ROSEN. I'm a professor from Berkeley and I really don't represent anyone except I'm going to give you my best view. I'm the head of the real estate center at the University of California at Berkeley and really have analyzed the real estate market carefully.

It looks to me that 85 percent of the problem that thrifts have are because of these real estate type activities and if you liquidated quickly—let's say in Colorado or Texas—the loss to the Government would be considerably greater than if you had a 5-year work-out period. In other words, you should take over the institutions, the FDIC should have the assets, but if you tried to sell the assets now, I think that's where the enormous size of the problem comes from. If you take Texas and Colorado as prime examples, roughly 55 percent of all losses that people are calculating come from those numbers, but they're evaluating those assets as if you liquidated them today at these fire sale prices.

I think the loss to the Government is not as large as people think if you were to liquidate these over a 5-year period. So if I were the FDIC, I would not liquidate them immediately. It would be a terrible error and cost the Government an extra $50 billion. People are going to get the money if people buy the properties now. Already Texas is beginning to recover. Houston has added 50,000 jobs in the last 6-month period. So I think it would be a terrible mistake and it can cost us, the taxpayers, an extra $50 billion if you do this quickly.

The CHAIRMAN. Senator Wirth, I might say that pursuing your line of questioning earlier, which I think was very important, if we go down the track with the risk-based capital approach or the risk-based insurance premium approach, and we end up with 50 different states going in 50 different directions or variations of directions, the supervisory and regulatory requirements of that are absolutely horrendous. That's one of the problems as to why $100 billion has disappeared. The notion that somehow we can hire enough people and put them to work to monitor all of that activity when the Federal taxpayer is fundamentally on the hook—I mean, the industry is being asked to pay an enormous amount of money here, but actually it's a relatively small fraction of the total that has to be provided now. The American taxpayer is being asked to foot most of it. I think in a situation like that, if you leave any areas in this proposal where these kinds of losses can come about again because of a too complicated a supervisory and regulatory structure and all kinds of risk profiles from all across the country, I think it's an irresponsible position for you to take. I just feel very strongly about it.

Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

I'd like to pursue again the discussion about the capital requirements and, Mr. Koch, if I could discuss it with you, there is some information that has been provided by the League with respect to the number of institutions that fall into various categories.

If I understood what you're saying collectively, I think was the longer term to raise capital and I assume that the reason that that needs to be done is because again the differential that you referred to—I assume what that does is reduce profitability and makes it more difficult to raise the capital. Therefore, there's a longer period of time that's needed.

The impression has been raised by more than one that if you allow for that longer period of time, those institutions are eventually just going to go into the morgue, as you referred to it. Therefore, why not do it now?

Mr. KOCH. OK. Before I answer, I want to be absolutely clear in that we are not suggesting any way, shape or form any kind of forbearance for those institutions. In fact, it was the National Council last summer who came out with very strong growth limitation requests and recommendations. I think this body adopted those suggestions almost in total. So we are very, very supportive of getting capital into the system.

Senator **Mack**. If I could, let me just interrupt you for a second. I'm new to the committee so I may not understand the distinction between the two organizations. One is the National Council and the other one is the League. Is there a different set of requirements to join one or are there different objectives or what?

Mr. **Koch**. Possibly because we are the smaller group I will answer. The National Council is made up of FDIC-insured savings banks, predominantly in New England, and FSLIC institutions around the rest of the country. Our asset mix is roughly 50–50. We have about 550 members in total and if you look at the membership mix, because of the smaller size of some of those savings banks that are FDIC-insured, the membership mix is about two-thirds FDIC-insured and one-third FSLIC-insured.

I might point out that the FDIC-insured institutions have had fairly wide powers for quite some time. They have been extremely profitable. You have not seen the kinds of debacle that you've seen around the rest of the country from those institutions. So while we understand there are problems with State powers, that's a group of institutions that has made out very well and wisely use the State powers that they've had in the past and haven't had any problem.

Senator **Mack**. Your point there I guess is that the expanded powers really didn't create the problem.

CAPITAL REQUIREMENTS

Mr. **Koch**. Well, there were lots of things that created the problem and I guess getting back to the original question on capital requirements, low capital has gone a long way to creating the problem. When people are operating without capital they take risks that they wouldn't otherwise take and I think, if you ever tally it up, that would be a major portion of the problem.

What we're suggesting is not terribly different than what the administration is suggesting on the capital requirements. In fact, we may even be suggesting something slightly more stringent. What we're saying is that you should go to those individual institutions, get a business plan from those institutions on how they're going to make their capital requirements, and make them step up at a given time—say every 6 months they have to increase their capital by some amount, so that they come up with a schedule that says by "x" day I'm going to have the required capital. If they fall behind on the plan—we're not suggesting that you get that plan and forget about them for 5 years. If they fall behind on the plan, corrective steps should immediately be taken.

The concern we have is that in 27 months, which is basically what you're talking about, there's 1,173 institutions that are not at 5.5 percent GAAP capital. Those institutions as a group for the first 9 months of last year returned zero on assets. In order for them to make the capital they need to return 1.25 percent on assets for the next 2 years to get to that capital requirement.

That's simply not realistic to be able to have them do that in that timeframe.

The great concern that I have is when we wiped out the capital in the industry in the early 1980's we dictated to an awful lot of institutions that they needed to take higher risks to try to make money and I am very, very afraid that we could potentially put institutions back into that same box where they're saying, "I'm going to be dead in 27 months. I've got to hit a home run." And they're not capable of hitting home runs. They can hit singles and bunts. And we don't want to encourage them to do that.

Senator MACK. Again, looking at the numbers that were supplied by the League, it looks like there are almost a thousand institutions that fall into the 3 percent to 6 percent category, which represent almost half of the deposit structure.

Are those the institutions that we were just discussing and, again, I guess what I would ask you, given the 5 years, what is going to make those institutions profitable?

Mr. KOCH. You're going to have to get your capital from two sources. One is from retained earnings, retained income. And the extent to which we tax away those earnings, it's going to be very, very difficult. The other source is the private capital market. We had the same situation in the savings banks in the early 1980's and we had a ½ percent increase per year required of those institutions. Most of them made it. A lot of them made it by finding merger partners, converting to stock. And that's why our great concerns are it's very obvious to us that this capital cannot be generated even in the relaxed timeframe we're talking about through retained earnings. So it's got to come from somewhere else, namely the private capital markets; and it's imperative that we don't discourage those outside markets from investing in our institutions. We have to do things that encourage them to put money in.

Senator MACK. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Mack.

Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Gentlemen, I'd like to ask this sort of simple question. Why should an institution which engages in risky activities be covered by Federal deposit insurance?

INSTITUTIONS INVOLVED IN RISKY ACTIVITIES AND FEDERAL DEPOSIT INSURANCE

Mr. BEEKSMA. In addition to the answers we've already given——

Senator SARBANES. What were the answers that were already given? I was here and I heard them but you could include them in your response to my question.

Mr. BEEKSMA. Those activities, as my associate here has said, those activities should not be covered by insured deposits.

It's a question of whether the institution is covered or the activities are covered and we're saying those kinds of activities ought to be properly insured against by capital. But to say that the alternative is to withhold federal insurance from the entire institution, we do not see as an acceptable substitute.

Senator **Sarbanes**. So you would extend the deposit insurance to the institution but then allow the institution to engage in a range of risky activities. How would you accomplish that?

Mr. **Beeksma**. We do not endorse any risky activities, if you want to say by risky, excessively risky, meaning more than normal mortgage lending and related activities.

Senator **Sarbanes**. Then your answer to my question, I take it, is that you do not think the institution should have insurance if they are going to engage in risky activities?

Mr. **Beeksma**. I think that's a fair statement, if they're going to engage in excessively risky activities.

Senator **Sarbanes**. Now do you think that under State powers a number of institutions engaged in excessively risky activities?

Mr. **Beeksma**. Is that a past tense—did involve?

Senator **Sarbanes**. Yes.

Mr. **Beeksma**. Yes. I think in the past there has been that kind of activity.

Senator **Sarbanes**. And is it still possible to do so?

Mr. **Beeksma**. Under State law, yes, it is.

Senator **Sarbanes**. Well, I'm not sure what that means. It is possible to continue to do so?

Mr. **Beeksma**. Yes.

Senator **Sarbanes**. Now why should that situation be permitted?

Mr. **Beeksma**. Well, Senator, you do an excellent job of phrasing questions, but let me say that——

Senator **Sarbanes**. No, I'm not trying to do that. I'm just trying to develop this thing. It's really following along a line or series of questions that the chairman put to you at the outset.

Mr. **Beeksma**. We're trying to suggest a procedure whereby the insurance fund can be protected from these sort of things is a combination of adequate capital, owner equity provided to cover those activities, and proper supervision at both the State and Federal level, to ensure that that risk does not include the insurance fund.

Senator **Sarbanes**. It's not clear to me how that protects you if they can still engage in the activities. I mean, it's the engaging in those activities that carries with it the high risk and brought a lot of the grief that we are now confronted with, is it not?

Mr. **Beeksma**. Let me ask Ken Seaton to respond.

Mr. **Seaton**. Senator, I believe there are Federal Home Loan Bank Board regulations in effect within the last 2 years called the equity risk investment regulations that require higher capital of institutions that want to get into these types of loans that I think are considered risky—commercial construction, land development, direct investment—and so these have substantially been restricted under present regulations. Admittedly, they have come into place after most of the damage has been done.

Senator **Sarbanes**. Do you see a range of activities that is so far beyond the pale that it should not be permitted even with the extra requirements?

Mr. **Seaton**. I think one which happens to be open to federally-chartered as well as to State chartered institutions is making 100 percent commercial real estate construction loans. That's not realistic. It should be cut back.

Senator SARBANES. You think that should be precluded altogether?

Mr. SEATON. Well, our normal——

Senator SARBANES. Let's not get on the specifics. Just as a general proposition, do you think there are a range of activities that are so risky that they ought not to be permitted for an institution that has federal insurance?

Mr. SEATON. Percentage loans, this type of loan that I just described, yes, this should be prohibited. That should not be permitted.

Mr. BEEKSMA. I would agree, Senator. A specific answer to your question is, yes, there are current activities that should not be allowed. Those ought to be addressed.

Senator SARBANES. All right. Now you then think that there is a range of activities that you would describe as risky that in fact exceed what are permitted to federally chartered institutions but that you would permit requiring those certain—well, I'm not quite sure whether it's more capital or higher insurance premiums or a combination thereof. Is that correct?

Mr. BEEKSMA. That's correct.

Senator SARBANES. Now how do you see that as protecting you? My perception of some of these institutions that went bad was that even if they had had more capital or were paying higher premiums they would still have gone bad, wouldn't they?

Mr. BEEKSMA. Probably.

Senator SARBANES. So how does the higher requirements protect you against that situation?

Mr. BEEKSMA. Well, I think the line of reasoning is if I engage in an activity that has the potential of costing me $1 million and I'm dealing with my stockholders——

Senator SARBANES. Costing who $1 million

Mr. BEEKSMA. The institution.

Senator SARBANES. And the taxpayer.

Mr. BEEKSMA. No, the institution. If you have $100 million of capital, my stockholders are not going to sit still for me engaging in that activity and losing $1 million of their capital.

Senator SARBANES. And you think this happened because enough capital wasn't required and therefore you didn't have that string on the operators of these institutions?

Mr. BEEKSMA. Many, many of our problems are due to the fact that there was not adequate capital in place.

Senator SARBANES. Well, that capital is pretty thin, though, even under most requirements. How high do you think it ought to be?

Mr. BEEKSMA. Well, I think the number that we come to is about 6 percent of assets.

Senator SARBANES. That's not much of a buffer once the things starts in a deteriorating situation, is it?

Mr. BEEKSMA. Yes, it's a good buffer when you deal in terms of those activities with only a small percentage of your asset base and, as my associate has stated, the bill contemplates 100 percent equity support for those activities so we have complete support by capital.

Senator SARBANES. Mr. Koch, do you want to respond?

Mr. Koch. Yes. The bill proposes that those activities be put into a separate subsidiary of the institution and whatever is invested by an institution and the capital be subtracted by the net worth of the institution when calculating its net worth.

So if you take this example of a $100 million net worth requirement, if the institution set up a subsidiary and moved the million dollars of net worth into that subsidiary to engage in that type of activity, the regulators would only look upon him as having $99 million at that point so in effect you have removed the Federal insurance coverage from that activity.

Senator Sarbanes. Do you think the subsidiary could go bust without affecting the institution itself that's covered by the deposit insurance?

Mr. Koch. I think that's what they are talking about doing.

Senator Sarbanes. I understand that, but do you think that's realistic?

Mr. Koch. Sure.

Senator Sarbanes. You think the public can read about the subsidiary of some financial institution going bad and not have concern about the institution itself?

Mr. Koch. The Federal requirement should be set up so that the amount invested in that subsidiary is at risk and is subtracted from the net worth of the parent institution.

Senator Sarbanes. Well, I understand that. I'm addressing a situation—well, my time has expired. Let me just make these observations in closing.

Gentlemen, if you want to go out and take risky efforts with your money or money you've accumulated from others on the basis of doing that, that's fine. That's the system. It's not quite clear to me why you ought to be able to engage in that activity when you're getting the money on the basis of Federal insurance.

Now what happened here is a lot of States permitted a whole range of activities which even the responsible people in the industry were concerned about, as I understand it.

Were the responsible people in the industry concerned about what was going on in segments of the industry?

Mr. Beeksma. Absolutely.

Senator Sarbanes. They didn't think this was a way for people to be functioning in carrying out their activities? There was no cost to it. It was covered. They got the money on the basis of insurance and then they went out and risked it as though they were freelancing entrepreneurs. Somewhere you've got to break that connection. If you're going to get the insurance, it ought to be for a clearly perceived public purpose. We're not providing that insurance for a private purpose. It's being provided for a public purpose.

Now if you want to engage in a whole range of speculative private activities with your own money or with pooled money of others who want to do that, that's your business and our system permits that and you may hit it big and profit enormously and you may not and then you lose what you speculated with.

But the justification for the insurance is a public justification and that's the test that has to be met.

Mr. Seaton. I think, Senator, that the industry does have the focus on housing and the great majority of our activities should be directed in that area. Therefore, a small percentage of our investments would be in these areas that you would consider with more risk.

So with that small investment, the 6-percent capital or greater capital, as you get into these other types of activities you're not betting the shop.

Senator SARBANES. Does the industry support a high requirement of its activities focused directly on housing?

Mr. SEATON. Absolutely.

Mr. BEEKSMA. Absolutely.

The CHAIRMAN. We'll come back to that. I know it's difficult to just break these up because there's a certain logic that has to be carried through. We've had two Senators join us, Senator Shelby and Senator Kerry. Did either of you want to make an opening comment?

Senator Kerry.

Senator KERRY. No, thank you, Mr. Chairman.

The CHAIRMAN. Senator Gramm.

Senator GRAMM. Mr. Chairman, as I read the testimony, especially Mr. Beeksma's testimony, I see the paragraph:

> The administration's proposal would cripple the Federal Home Loan Bank System and result in the liquidation of this Nation's viable thrift institutions. The system would be sacrificed to pay for losses created by a handful of renegade operators the regulators failed to constrain.

Let me just pose a very short question and then a little bit longer variant of it. I'd like to ask you all if you really believe that the plan proposed by the president is unfair to the thrift industry.

THE ADMINISTRATION'S PLAN TO THE THRIFT INDUSTRY

Mr. BEEKSMA. The answer is affirmative, yes.

Mr. KOCH. The plan as proposed will aggravate the taxpayer cost. If you think about it, the thrift industry is bearing costs in this thing and the taxpayer is bearing costs. We have a very, very strong kindred concern that the taxpayer has that we minimize the costs and we haven't done that with this plan at this point in time.

We think the framework is OK, but the plan itself is not going to minimize the cost to either of us and it very well may destroy the industry in the process which would further exacerbate the problem.

Senator GRAMM. Since I may not get back to that, I'd be happy to have in writing—and it doesn't have to be anything fancy—your suggestions on ways that we can lower the cost of the program, because I am very much interested in that.

Mr. Beeksma, let me ask you, as a spokesman for the League, when the FSLIC fund in essence went bankrupt, which is what happened, creating tremendous losses, whose responsibility, looking at it in any kind of legal sense, do you think it was to replenish that fund?

Mr. **Beeksma**. Well, it's the responsibility, of course, of those charged with administering that fund to replenish the resources. Ultimately it's a Government agency which entered the deposit insurance business 55 years ago to protect the American people from possible losses.

Now the logical approach to that problem is that you assess the participants in the fund as much as is practical, as much as you can, and then you have to look elsewhere. It's just a given you have to look elsewhere.

Senator **Gramm**. I would say that in any kind of legalistic sense, and obviously we're not looking at it that way, but in any kind of legalistic sense, this insurance fund belongs to its members, and the Federal Government had every right to take every asset of every member.

That's why I'm so shocked to read these statements that somehow the thrift industry is being abused by this plan. Quite frankly, I think this plan is very favorable to the industry, based on anything that might have been reasonable, especially when your association 2 years ago came out and said that $5 billion was enough of a recapitalization, that a $15 billion recapitalization was unnecessary and unduly burdensome.

Mr. **Beeksma**. Senator, I wish I had a lot of time to respond to that because that's a different debate entirely. But let me make it clear that this business and the U.S. League never said that $5 billion was adequate. We never took that position. At the time that debate was engaged, nobody knew what the size of this problem was.

Our approach very simply was that we wanted congressional oversight of this process and we addressed a 2-year timeframe saying let's fund enough to resolve problems over the next 2 years in accordance with the needs of FSLIC and revisit this issue to see what we then know about the size of the problem.

Nobody ever stated that $5 billion was adequate or that even $15 billion was adequate because nobody—even the source, the Bank Board—did not know what the size of the problem was at that time.

Senator **Gramm**. Let me just say here, thanks to my trusty staff, they've just handed me a letter that you sent to GAO. You accused the Treasury of trying to frighten Congress into passing a bloated plan. That letter was March 6, 1987.

Mr. **Beeksma**. Yes. We felt that $15 billion was in fact irresponsible because the way it was arrived at was it very simply present-valued the entire future cash flow to the FSLIC for 30 years and that resulted in $15 billion and the FSLIC were going to spend it immediately in a system that was totally unable to spend that money efficiently to try to resolve the problem.

Had that been done, I think the problem would have been worse today because the money would have been spent irresponsibly.

Senator **Gramm**. Well, I tell you, I don't blame you. You've got a tough job being a spokesman here, but if anybody on Earth has been irresponsible on this issue, it's the League. The position taken by the League is rivaled only by that of Members of Congress in terms of absolute irresponsibility on this issue.

Mr. BEEKSMA. I would hope one of the other Senators would choose to address that issue because I would love to respond further.

Senator GRAMM. Well, I'm sure you all have got lots of friends here, but less than you used to have. [Laughter.]

Mr. BEEKSMA. I wonder if you could be candid, please?

Senator GRAMM. Well, my time is up. I don't see the chairman back. Let me ask you to explain why you think we ought to merge the insurance funds?

Mr. BEEKSMA. Because in the insurance business anywhere in the country normally insurance companies operating in any State enter into some kind of a pool. One company goes, the rest of the insurance companies step in and assist and ultimately the taxpayers in that State assist when you have a shortfall. That's just the way the system works. It only makes sense to me for Congress to consider all available sources of revenue and if you have a future ongoing premium stream that could address this problem as opposed to hitting the taxpayer, it just makes sense, from an insurance underwriting concept.

Senator GRAMM. It doesn't bother you that that FDIC fund belongs to the banks.

Mr. BEEKSMA. Let me assure you, Senator, everything in this process bothers me.

Senator GRAMM. Thank you, Mr. Chairman.

The CHAIRMAN. That was a good example of how important it is to maintain regulatory supervision every second. [Laughter.]

Senator GRAMM. You need to remember that, Mr. Chairman. It's dangerous.

The CHAIRMAN. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

I want to follow up on a statement. It was a statement made a minute ago that the administration proposal some of you thought would basically destroy the industry.

The CHAIRMAN. Excuse me, if you would. Any time you give an affirmative answer——

Senator SHELBY. You said yes?

Mr. BEEKSMA. Yes.

Senator SHELBY. It seems to me that you have already destroyed the industry. I saw the other day—and it was worth remembering—that someone wrote—it was in one of the papers, the Wall Street Journal or the New York Times, the Post or something—and somebody was writing an article and said that they had worked for the Federal Home Loan Bank Board at one time out in Oklahoma or Texas and said that he got into supervising or trying to supervise and he said that the best analogy he could think of was that it was like letting hospital orderlies do brain surgery. That's what he said was happening when we deregulated and you were not supervised.

Now following up on what Senator Gramm brought up, I was sitting on this committee 2 years ago, as he was and a lot of us were here, and we do remember the $15 billion figure and the $5 billion that we came out with and I don't recall if your group said that was enough, but I know that there was no movement toward $15 billion because people were saying we don't really need that much.

And it comes home to roost now as to any organization—say the Federal Home Loan Bank Board and FSLIC, which they supervise, would not know the depth of the problems—and they were deep then. Maybe they didn't want to know the depths of the problem.

So you come before this committee—and you know this—you have no credibility here today. As Senator Gramm said, we're all friends, but as he said, you had more friends 2 years ago and I think by that you had more credibility. So we've got the problem here. It's not going to go away and it's with us and it's going to cost a lot of money.

MEETING THE 6-PERCENT CAPITAL REQUIREMENT

Now my question is this. How many savings and loans or thrifts would be able to grow to the 6-percent capital requirement from where they are now, in other words, the second tier? Say you close all the ones that are insolvent right now. How many more will go down because of the lack of capital moving from 3 to 6 percent?

Mr. **Beeksma**. Over what time period?

Senator **Shelby**. 3-year timeframe.

Mr. **Beeksma**. Well, let me say that as with the size of the problem, the answer to that question is addressing a moving target because you tell me what interest rates will be over the next 3 years and——

Senator **Shelby**. Well, you all have been a target. I'll say that.

Mr. **Beeksma**. Well, let me put it this way. The majority will make that, but as interest rates change and profitability changes—that's the problem. The profitability is the key to building and attracting this capital. That is the key.

Let me say this. It will be the majority, a vast majority of this business will make those capital requirements within a reasonable timeframe. It depends on profitability levels.

Senator **Shelby**. How important is the intangible of goodwill in meeting these capital requirements? Does it depend on the institution?

Mr. **Beeksma**. As to whether it's included or not, in a certain number of institutions it is very important. It's essential.

Senator **Shelby**. Do you have a number on that?

Mr. **Beeksma**. Not an exact number. It would be several hundred.

Senator **Shelby**. Several hundred you think couldn't use the good will in the capital requirements being met, they would be in trouble? They wouldn't make it?

Mr. **Beeksma**. Right. Could I ask Jonathan Gray to respond to this question?

Mr. **Gray**. Good morning. I'm a securities analyst. I'm not with the U.S. League of Savings Institutions.

Senator **Shelby**. You're probably doing better before us already. Go ahead.

Mr. **Gray**. That's not to say that I dissociate myself from all of their points of view, but some of them.

Fifteen percent of the industry is dead. Seventeen percent of the industry is moribund. It's on its way out. There is a 40- to 45-percent slice of the industry with about $550 billion in assets which has a chance—can only meet the capital requirement in 3 years if it stops growing, assuming stable return on assets. In other words, freeze profitability where it was 6 months ago before the rise in interest rates had any impact, and if this group of companies stops growing, it can meet the capital requirements. There are 870 companies, 45 percent of the industry, $550 billion in assets. The top 25 percent of the industry is OK. But the point is, what is the significance of this? Seventy-five percent of the thrift industry is out of the mortgage market. They write half the loans in the country. They hold 40 percent, two out of every five mortgage loans. They have been eliminated from playing any significant role in financing homeownership for several years. That assumes stable interest rates. If you take rates up dramatically, as is in my opinion likely to occur, you have a prolonged crisis in the industry. Talk about it never happening again, you have to make this stop first, this crisis. And the next chapter in this crisis may very well be in the process of unfolding.

But the point is that the answer was how many could meet the capital requirements. Given the rise in rates that's already occurred, perhaps 2,000 out of 3,000. With any further rise in rates you're down to 1,300 out of about 3,100.

Senator SHELBY. It goes down the other way each day with the further rise in rates. It makes the gap wider.

Mr. GRAY. The rise in rates that's already occurred is just now having an impact on the industry. In all likelihood you're talking about 1,300 companies but only 26 percent of the industry's assets. The strongest tend to be smaller companies. So the vast majority of the industry will not comply within 3 years.

Senator SHELBY. Most of them in that second group you mentioned, the big group, they've got economic cancer. It's a question of who's going to get some treatment, isn't it?

Mr. GRAY. Well, the economic reality is that these companies are either dead or are on their way out and the issue here really, aside from whether the survivors or those that survive today who have a chance of being viable, the issue may not be whether they're good guys or bad guys, how responsible or unresponsible they've been in this obscene loss for the taxpayer. The question is the issue of financing homeownership and whether this crisis is going to go away and to what is the extent of the taxpayers' liability.

Senator SHELBY. The second phase is what I'm getting at. We don't take a hit now but some people say, well, a lot of them were going to grow out of it and take the hit later. That's concerned a lot of us on the committee because we want to try to meet this credibility problem head on and try to deal with the administration on the second hit that we're approaching.

Mr. GRAY. There's one issue that hasn't surfaced at all in the dialog this morning and that's the issue of actuarial science. When you run an insurance company you attempt to measure risks and manage risks by being able to measure it. This has been an insurance fund that's been run for over a decade with no way to manage risk. Is it any surprise that it's bankrupt? Yet the three people who sat on the Home Loan Bank Board also were the chairmen of Freddie Mac which has superb underwriting experience. It never occurred to them to apply what they saw at Freddie Mac or Fannie

Mae to the industry that they regulated. There are underwriting criteria that exists. If you look at one loan out of every 40 and you apply those underwriting criteria, you know what the loss experience is? The FSLIC would be the most profitable insurance agency in the United States if it applied those criteria. The losses are 1/160th what the losses are in this bottom segment of the thrift industry. They're 5 cents per $100 of assets, not 8 cents or not even 23 cents, the proposed insurance premium. The FSLIC would be making money hand over fist. It could go public.

Senator SHELBY. My time has expired, Mr. Chairman. Thank you.

The CHAIRMAN. I think that's a very important exchange because it helps illustrate too that this has the potential to be a very profitable business and in fact has been and continues to be for an awful lot of people that have sort of kept their eye on the mortgage lending function.

Senator Bond.

Senator BOND. Thank you, Mr. Chairman.

After listening to some of the questions and dialog of my colleagues on the committee, I would only say to the witnesses today, welcome to the kinder and gentler world of Washington, DC.

Now having said that, I think it's important to point out that I believe we recognize—I hope we recognize that a healthy and strong savings and loan industry is necessary after we put this plan in place if we are to get the maximum participation from the industry in helping to pay for the problems that have occurred in the past.

It's fun to jump up and down and say we're going to slay the industry, but that just makes the bite out of the taxpayers' backside bigger. Frankly, I would hope as we approach these problems that we can discuss and have your views on how we can assure the growth and assure the maximum participation possible from the savings and loan industry because to me that's the only way to avoid putting an even bigger burden on the taxpayers.

I'd like to offer Mr. Koch an opportunity to comment on the proposal Mr. Beeksma made to go ahead and merge the FSLIC and FDIC funds. What do you think about that, Mr. Koch?

MERGING FSLIC AND FDIC

Mr. KOCH. We are not in support of an outright merger of the funds where the banks paid in premiums would be used for the savings and loan problem.

However, we are very much in favor of a slightly different spin on the ball, if you will. It seems imperative to us to not build regulatory walls between the commercial banking industry and the savings and loan industry because when all is said and done, what we heard here a few minutes ago is there's not enough capital in the system to absorb or build to the kinds of net worth requirements the system needs to be built to.

So it's very, very likely that we're going to need to attract that capital from the commercial banking sector to absorb some of these failed institutions or some of these institutions that can in fact meet the net worth requirement.

Senator BOND. And you'd like to see the bank holding companies be able to buy healthy thrifts right away?

Mr. KOCH. What we are suggesting is that beginning almost immediately healthy savings and loan institutions that meet the capital requirements of the FDIC be allowed to move into the FDIC and become part of that fund. So that over a 4 or 5 year period you would end up absorbing all the healthy institutions into the fund.

What is key to that proposal is that it also allows the free access of the commercial banking sector into full participation of acquiring insolvent institutions or maybe these institutions that are the in-betweeners, so to speak, so that we can in fact attract capital into the system and put this problem behind us.

If you build a barrier and create a 5-year moratorium and create exit fees and entrance fees, you're going to disincentivize people from investing in the industry, whether they are commercial banks or private investors. You need to be able to have a free swing back and forth between those two industries.

Senator BOND. I would question whether we can afford to do that because we can't afford to lose the participation from the healthy members of the industry because they are part of the insurance risk pool.

Mr. KOCH. We're suggesting that one way to do that would be to have the newly admitted FDIC members, the ones that are coming over from the old FSLIC, to pay basically two sets of premiums—one premium to the FDIC insurance fund, let's call it the 15 basis points; and for some period of time pay the differential—let's say we're into the 18 basis point—pay the extra 3 cents into some other fund, whether it be REFCORP or somewhere else, so that you would not lose all that revenue and there would be, if you will, a thrift admission test where you have some differential.

We're not saying you have to have actual 100 percent parity, especially immediately. We are saying that you need to have relative parity so that as you go down the road there's not a huge gap between the premiums of the two industries.

Senator BOND. There are more things that we might want to follow up later on that, but I'd like to pose a question to all the members of the panel—something that I don't think we've addressed sufficiently today.

I am most interested in the enforcement powers of the bill. Do any of you have comments on the administration's proposals? Are they tough enough? Are they too tough? Are there changes that you would like to see in what the administration proposes in S. 413?

Mr. BEEKSMA. We support enforcement powers. We always have. We have been I think improperly criticized as resisting those in the past. I think there was a movement a number of years back on enforcement powers that would in fact jeopardize due process provisions of the constitution and elsewhere we had concerns with. Otherwise, we support increased enforcement powers.

Senator BOND. As they stand in the bill now?

Mr. BEEKSMA. Right.

Senator BOND. Mr. Seaton, Mr. Rosen, any comments on that? Mr. Koch, any changes that you would want to see in the enforcement powers?

Mr. **Koch**. The National Council fully supports the proposed enforcement powers and we have in the past and we continue to support those types of enforcement actions.

Senator **Bond**. Thank you. I'm delighted we've found an area of common agreement and I will yield back the balance of my time. Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Bond.

Senator Pressler has joined us. Did you have an opening comment before we go to the next set of questions?

Senator **Pressler**. I have no opening statement.

The **Chairman**. Thank you.

Senator Bryan.

Senator **Bryan**. Thank you very much, Mr. Chairman.

I'd like to preface a comment or two before I ask a question, Mr. Beeksma, of you.

I share your view that the long-term viability and the health of the savings and loan industry is an important asset for us in America in terms of providing housing, which is one of our primary concerns and something that this committee is going to be very much involved with. But I believe it was Senator Shelby who used the word credibility, and your credibility has been damaged.

I think it's important in terms of working with this committee that the industry and the League in particular offer us some constructive comments of how we can strengthen this bill, how we can make this bill a stronger piece of legislation so that we don't have to revisit the problem again.

With respect to the credibility issue, I don't know whether you have seen it, but this morning the Wall Street Journal, Mr. Edwin Gray, the former Chairman, is quoted as making this statement—and I'm going to share it with you and ask for your response.

"Mr. Gray views the League's comforting projections as part of a cold-blooded deception." This is a direct quote from him. "The League knew damn well what they were telling the Congress was untrue." The League's motive, he contended, was to let the losses get so big that only taxpayers, not the industry, could afford the bill. Now this is an individual who was a former great advocate and supporter of the League, as I understand historically.

Can you respond to the contention? If that's true, that's a damning indictment of you and your organization.

RESPONSE TO EDWIN GRAY'S VIEW ABOUT THE U.S. LEAGUE

Mr. **Beeksma**. Let me make this response, Senator. Chairman Gray, of course, was in position for the nearly 4 years during which time this entire thing occurred and it is only natural for him to try to seek out people to blame other than himself.

Let me just say that the record is very clear that in the early 1980's, specifically 1980 and 1981 and 1982, the interest rate environment in which we operated, 80 percent of our business was losing money and the U.S. League was at the forefront of trying to preserve our business and get the Garn-St Germain Act and other things that would allow us to survive in that environment.

The record is equally clear that beginning in 1984, 1985, and 1986, as we saw these things begin to unfold—these regulatory problems—and we will happily provide an entire file of documentation where we supported tighter controls, greater restrictions, greater enforcement powers, and all of the rest, all of which is now conveniently being ignored by the former Chairman. We will provide that file happily, Senator.

The CHAIRMAN. We will look forward to receiving that and making it a part of the committee's records.

Mr. BEEKSMA. Thank you.

Senator BRYAN. I take it your response is that this is not true, the allegation made by the former Chairman.

Mr. BEEKSMA. We would stand firmly on the position that there are lots of people to blame, but it certainly is not our——

Senator BRYAN. I don't mean to be contentious, but I would think that when you're faced in this kind of an allegation that in effect you deliberately, with a calculative motive, misled the Congress of the United States so that you protect your own self and your own industry and your own resources to get into the taxpayers' pocket, that that's a serious allegation that you would want to tell us in a sense of outrage if it's not true, no, it's not true. You're kind of weaseling on it.

Mr. BEEKSMA. I will respond very simply. It is untrue. It is a falsehood and we deny every part of it.

Senator BRYAN. All right. Well, I would think——

Mr. BEEKSMA. And we would welcome the opportunity in open court to debate this issue or defend ourselves.

Senator BRYAN. Let me now shift the focus to the powers, the question I think that Senator Bond was addressing.

Are there any powers that are provided in this bill—you've indicated you support those powers and I invite this response from Mr. Beeksma, Mr. Koch or Mr. Seaton or Mr. Rosen—are there any additional powers that are needed?

Let me tell you an area of my concern and that's the dual charter system that the chairman addressed during his opening comment and his colloquy with you. That is, do we need at the Federal level, if we're going to continue to insure State-chartered savings and loans, do we need a broader range of powers to screen who are the owners, who are the people in control, who are the directors? Seemingly, those powers have not been available in the past and there are at least some who would say that some of the outrageous misconduct was a product of those individuals who gained control of those savings and loans.

Mr. BEEKSMA. Senator, it is absolutely essential that you screen more closely those who come into this business. The record will support that most of the problems have occurred in institutions which were acquired within the last 5 years by owners that could have been kept out of the business by the regulators then in charge.

Senator BRYAN. Does this piece of legislation that we have before us give us the tools at the Federal level to prevent a recurrence of that or do we need some additional powers?

Mr. BEEKSMA. I would defer to someone more knowledgeable on that specific thing.

Senator BRYAN. Let me just ask one other question because my time is running out.

On page 3 of your testimony, you make the comment "We endorse risk-based capital guidelines phased in over an appropriate period of time and with appropriate grandfathering." The emphasis is mine.

What do you mean by appropriate grandfathering?

Mr. BEEKSMA. We have some good will in our business that is the result of supervisory activities—taking over troubled thrifts it created good will. We would like to ensure that that is grandfathered. There are some deferred loan losses allowed under regulatory accounting principles which were encouraged by former regulators. We're asking that prior deals that were agreed upon with regulators be honored. Simply, I think a common sense approach taking into consideration what was agreed upon in the past.

Senator BRYAN. I must say that the RAP accounting system is hardly one that invites itself for great commendation as far as I'm concerned.

Mr. BEEKSMA. We are not defending RAP at all. All we're saying is that there is within the RAP accounting this provision of deferring loan losses which needs to be addressed by somebody because it is a big issue.

Senator BRYAN. And you're saying let those past bygones be bygones and if it was allowed and approved it ought to be perpetuated into the capital formation requirement?

Mr. BEEKSMA. We're suggesting there needs to be some flexibility in analyzing how those are considered in each institution.

Senator BRYAN. My time is up, Mr. Chairman. Thank you.

The CHAIRMAN. Thank you, Senator Bryan.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Again I apologize for having to leave and as I left this committee room and went down to the Appropriations Committee I walked into Senator Byrd asking Secretary Brady questions about the S&L bailout plan. Two different rooms, two different hearings, and the discussion was exactly the same. So I didn't leave the discussion.

In the interest of time, Mr. Chairman, I would ask that the majority of my questions be submitted for a response in writing for the record.

I understand that while I've been gone there's been a great deal of discussion today about reining in State powers of federally insured thrifts and I generally agree that we've got to do something about that. There's also been talk about redesigning the charter of all thrifts so they engage almost exclusively in mortgage lending.

I have to say that that concerns me. I certainly don't want to throw the baby out with the bath water. As I look at revisionist history about some of the problems, deregulating interest rates and doing away with reg. Q and the differential, constantly come up as a solution to a good part of the problem.

Yet even in hindsight, looking back at that particular situation with over $300 billion outflow to the money market accounts which were paying 15, 17, 18 percent, and all of the sweep accounts that banks and thrifts were trying to invent so they could keep inflows of capital, at 5.25 and 5.5 percent interest, nobody was crazy enough in this country to say, "I'm going to put my money in a 5.5-percent account if I can get 17 percent someplace else." So I still think that that had to be done. There is no doubt about that in my mind in hindsight.

There is also no doubt in my mind that if we hadn't made some reasonable deregulatory efforts at the Federal level—not going to the extent that the States did it, as we have so adequately discussed in California and Texas—that we might have precipitated the crisis sooner. Maybe that would have been positive. I don't know.

My point is that I'd like you to respond, if you can, to this question. Where is the balance? I have fears that if we went back to say, "OK, let's make them put a large percentage of their assets back in mortgages," that we could cause just as much of a crisis as if we continued to allow some of the abuses that the State legislatures allow by granting too many risky powers, which we have so adequately heard about in these hearings.

Can you give this committee some idea of where the balance point is between keeping an industry viable that is supposed to be in the mortgage lending business for the benefit of the housing industry in this country and toning down these abusive powers that we've had in order to restore some balance. Can I get some answer to that question?

FINDING THE PROPER BALANCE

Mr. KOCH. Senator, I mentioned in my opening comment that I'm a Federal savings bank by charter, so I live under the Federal powers.

We anticipate that this year we will have record profits. Quite frankly, interest rates have risen dramatically. In my institution, my spreads are widening, not narrowing, as a result of increasing interest rates. The only reason in the world for that is the fact that I've been able to utilize to some extent the powers authorized under Garn-St Germain. We have diversified a portion of our balance sheet into consumer lending and to other assets that are more variable rate in nature, and those assets are adjusting upward now enough to absorb me against the losses that I'm incurring in my fixed-rate mortgage portfolio. I still have over 70 percent of my assets in mortgages, but I desperately need some flexibility to keep the bottom line flowing in adverse economic conditions for the institution.

Senator GARN. Well, I agree with that in general, but if you can be more specific of how we balance that. I don't think there's anybody who would agree more than I that powers granted by State legislatures have gone far too far and are a major part of this problem. Senator Riegle has talked about 52 percent of all the losses being in Texas, alone. How are we going to balance this? How are we going to have a balance, first of all, between mortgage lending—and I'm pleased that you're doing that with more than 70 percent in mortgage lending—and additional powers that give you that flexibility? How do we create a balance between the existence of a dual banking system that allows the right of States to grant powers and the problem of Federal insurance that guarantees those funds.

Mr. BEEKSMA. Senator, let me respond to the question of the investment. I think we have a good pattern when we look at the healthy segment of our business. After all, this is the group that has survived the early 1980's, the last 5 years, and has done well. If you look at that group, you find that they keep their residential mortgage investment level at roughly 60 to 65 percent, which complies with the QTL test, and it allows a sufficient amount of diversification into the other powers to provide the kinds of benefits that Mr. Koch has enumerated.

I think presently where that segment is at is a healthy balance and it provides a majority focus on housing finance and yet allows the diversification required to succeed in adverse circumstances, difficult times.

Senator GARN. Well, for the sake of argument, let's assume that around 70 percent is a reasonable balance in that part of the question. What about the rest of the question and this problem of States going far beyond what Garn-St Germain Federal regulators allowed, putting all of these activities in difficulty with their expanded powers? How do we solve that problem? Simply cut it off and say if you want Federal insurance you must comply with Federal standards? The States' rights are simply gone.

Mr. BEEKSMA. In a lengthy dialog that occurred in your absence, Senator, our basic response to that at the U.S. League level is that that ought to be addressed by adequate capital standards in place prior to engaging in any of those powers and that certain of those powers ought to be eliminated just off the bat because they are completely irresponsible.

Senator GARN. Well, let me not rehash it if it's already been discussed then, other than to just ask one brief question.

How about putting the powers in separate subsidiaries? Is that a reasonable alternative?

Mr. KOCH. We think it is. We support the administration's proposal in that regard in that you put the powers in the subsidiaries. We think that we had is that they're talking about modeling it after a national bank charter. We suggest that it be modeled after a Federal savings and loan charter as opposed to the bank charter, but put it into a sub so that you can in fact isolate the situation away from the main bank and get it out of the Federal insurance system.

Senator GARN. Thank you, Mr. Chairman.

The CHAIRMAN. If I may, just to clarify that, before yielding to Senator Kerry, when you say put it in a subsidiary, what if we were to decide to put it in a separate affiliate under a holding company arrangement with some real fire walls so that there can't be any leakage back and forth, or do you still want the Federal deposit insurance to stretch over to cover those riskier activities in this subsidiary?

Mr. KOCH. The problem that you have is in a lot of cases you have mutuals that don't have the ability to get into the holding company format. I think what we're suggesting is that you isolate the sub in some fashion and we're proposing that if it is a sub of the bank it is in fact isolated. The capital that is invested in that sub be netted out against the capital that the bank has, so that you're basically putting 100 percent capital requirement on there which says that you're using the institution's capital; you're not using any of the leverage that you have from the Federal insurance system. So that whether it needs to be in a holding company or it can be isolated in a service corporation sub, I think the legal minds will have to address that question. But I think the intent that we're saying is to get it out of the federal insurance part of it and into an independent subsidiary of some sort.

The CHAIRMAN. I'm told that under CEBA a mutual can form a holding company, so you are not prohibited from doing that.

Mr. KOCH. I think at this point there's only one in the country.

The CHAIRMAN. Well, maybe there need to be more.

Senator Kerry.

Senator KERRY. Mr. Koch, there are currently some 1,173 institutions that are not insolvent but notwithstanding that don't meet the 6 percent capital requirement.

I think that represents something like $807 billion in total assets and some $27 million in GAAP capital. That means in order to meet the plan's requirements by 1991 they would have to come up to about $48 billion in GAAP capital, which is an increase in that time of $21 billion.

CAN THRIFTS MEET THE PLAN'S REQUIREMENTS?

Is that feasible? The only way they can do that is through subordinated debentures or profits or increased debt, et cetera. Are they going to be able to meet that kind of requirement in that span of time?

Mr. KOCH. Clearly not. They need to as a group—and I think it is probably pertinent to isolate the ones that are on the low end of the group versus the ones that are on the higher end of the group. We think that there's probably 300 or so that are close enough to the target that they can probably have a realistic chance of getting there. That leaves an awful lot of institutions out there that are well off the target, roughly 900.

They are going to need some sort of outside capital in addition to profits. I don't think subordinated debt is probably feasible. Possibly the institutional gentlemen here could comment on the ability for them to raise subordinated debt. I think what they are going to need to do is to——

Senator KERRY. They could issue stock, but will people want to buy it?

Mr. KOCH. Well, they could possibly issue stock. The plain fact of the matter is there's only been $10 billion of stock raised in the whole history of conversions and I think these institutions need something like $20 billion or so in this timeframe. So that gets to be a difficult problem also.

The only alternative is to merge with a better capitalized institution with a bank or a savings and loan.

Senator KERRY. Let me pick up on that because you've purchased unhealthy institutions in the past. Part of the theory here I think in the President's plan is that healthy institutions are going to buy unhealthy institutions and work out.

But given what you've just said about that capital gap—not the GAAP but the other gap, the difference between them—are you in fact going to look to purchase any of these unhealthy institutions in the current situation?

Mr. KOCH. I think that excess capital in healthy institutions should almost be looked upon as private capital. I have in my institution excess capital. I easily qualify for FDIC standards. I have capital over and above that which could be spent for some purpose. I think I have a fiduciary responsibility to my shareholders to spend that capital in the wisest fashion that's going to maximize their return.

The great fear that I have in this particular proposal that the administration has sent out is that I don't see where I will want to invest in more FSLIC-insured institutions or, if I were to invest in them, I would probably require a greater cost from the Government than I would otherwise do it. I can tell you that almost daily we are seeing in-betweener type institutions, institutions that do not have the capital that have come to the conclusion the only way out is to merge with somebody, approach us and many of these institutions we have been courting for several months to try to encourage them to join with us, and at this point in time I would be doing my shareholders a disservice if I were to merge with those institutions.

Senator KERRY. So the shorthand answer is that S. 413 currently is not really going to open up a significant amount of the purchasing of the unhealthy institutions.

Mr. KOCH. I think it goes the other way. I think it discourages the purchase of them.

Senator KERRY. Now I want to ask you about the State-chartered banks, but I do want to ask Mr. Beeksma first as time runs very quickly here—and if you're not yet in need of a transfusion, let me just ask you quickly a couple of questions.

In your testimony you place a lot of stock on the importance of the thrift industry for mortgage purposes obviously for the home market and argue very hard that the distinction between thrift and commercial is very, very important in the long run, so much so that it justifies the separate industry as well as a separate board.

Then you argue just as strongly that the insurance systems ought to be completely merged and that premium increases on commercials should be raised to pay for the insolvency.

How do you have it both ways? How can you argue on the one hand that there's such distinctness and separateness that they merit separate, and yet you're going to foist onto the commercials the redress for the problems that have occurred as a result of that separateness?

Mr. BEEKSMA. Well, Senator, my response would be that we are not foisting it on them, but we see the insurance responsibility or function as separate from the chartering and regulating function. Historically, we have had them together and I think many feel and would agree that that probably is part of the problem, that the regulatory board focuses on one or the other to the exclusion of the remaining at certain times. So we think that separating those two, placing the insurance responsibility with a viable insurance fund and revamping the separate regulatory structure with a charter or a charge to foster housing financing in this country through the savings institutions is an appropriate approach to this thing.

Senator KERRY. Well, I think my time is up. Let me just ask quickly, in your testimony in tables 1 and 2, you make this argument about the importance to the housing industry. But when you really look at that, I wonder if you couldn't argue that the glass is not half full but it's half empty in the sense that it isn't that the thrifts are providing such a critical element of the housing industry; it's a diminishing element. In fact, increasingly it is the commercial banks, the life insurance companies, State and local credit agencies and so forth that are increasingly providing for the housing market, and particularly if you subtract what you've credited to the savings institutions in their mortgage subsidiaries. If you eliminate those, it's even less a part of the market and diminishing. Isn't that accurate?

Mr. BEEKSMA. Those changes are not material. They are very narrow ranges like from 50 percent to 45 percent or something like that. The critical element missing here is the fact that many savings and loans have chosen to originate through mortgage subsidiaries, which figures are not included in our numbers. They then become mortgage banking numbers. A good example of that is my associate, Ken Seaton, who operates his institution that way. But those are in fact thrift originations and those percentages have not really changed very much historically going back many decades.

Senator KERRY. Just one comment that I would make because my time is up, and that is that I hope it may be possible as we construct this to think about how we can move beyond—if the thrifts are going to be important and maintained in that process—moving beyond just market value housing and see if there isn't some way to go further in the mandate into the low and affordable income and some means of reaching further.

Mr. Chairman, I appreciate the time. Thank you.

The CHAIRMAN. Thank you, Senator Kerry.

Senator Pressler.

Senator PRESSLER. I just have a couple of brief questions because many of my questions have been asked already.

Which of your associations here speaks more for the smaller savings and loans?

Mr. BEEKSMA. Let me say, Senator, that the U.S. League is the long-term trade association in representing the savings and loans. Virtually every savings and loan in the country belongs to the U.S. League and has for many years. In addition, we have some savings banks, FDIC-insured, in our trade association. I think we would purport to speak for the broad savings and loan business. We are the ones directly affected by this bill and by this problem.

SMALL SAVINGS AND LOAN INSTITUTIONS

Senator PRESSLER. I'm trying to figure out how this bill will affect the small savings and loans in my State of South Dakota. This is a parochial question. If the requirement to increase your capital to 6 percent by June 1, 1991, do you think they are going to be able to do that?

Mr. **Beeksma**. It comes down particularly hard on the small community-based association because that is the institution that finds it most difficult to attract this capital. As earnings are depressed and the ability to build capital internally is restricted, the access to the market just is not there for those institutions. So it's most problematical for that group.

Senator **Pressler**. What will probably happen if we pass the bill without amendment?

Mr. **Beeksma**. Unless that burden is lifted on that group, unfortunately, many of them will be lost through merger and acquisition.

Senator **Pressler**. And so your idea of the 5-year phase-in to a new higher rate, although that might result in more losses if we stretched the period out, would that help the small institutions? What can we do in terms of an amendment?

Mr. **Beeksma**. It helps the small institution. We do not necessarily agree it increases the potential for loss. We say that in the interim there needs to be close supervision of that group to make sure, as Mr. Koch has indicated, that there is progress made toward that goal. If there's not progress being made, certainly pull the chain.

Senator **Pressler**. What would happen if we had an amendment that would apply just to a certain class of savings and loans, small ones, that would be treated differently, or would this fly in the face of something else?

Mr. **Beeksma**. I don't know that it would fly in the face. It creates kind of a dilemma as to how you structure that, but I think it's certainly something that we'd like to pursue and discuss with you.

Senator **Pressler**. Mr. Chairman, that's something I'm very interested in is if the staff could start looking at the possibility of giving some protection to small savings and loans below a certain level. I know that everybody wants an exemption and everyone wants changes. My savings and loans in South Dakota where we have an agricultural depression, where we have really an economy that's extremely weak, they say the 6 percent thing will put them out of business. I don't know if there's a way that they can be accommodated by an amendment, but it's something I'd very much like to work with your staff on, Mr. Chairman, and with everybody. Thank you.

The **Chairman**. I understand the concern and we will work with you on the problem of the savings and loans in particularly the rural areas where there's a unique economic situation as to how the mortgage lending function can continue in those areas.

Did you want to add a comment, Mr. Koch?

Mr. **Koch**. Yes, Mr. Chairman. I agree with the Senator that something needs to be done for small institutions, but it sounds an awful lot like the dialog that we heard in the past about forbearance and there's—small institutions add up to numbers and you can get large losses, and I would be very, very concerned that we don't end up creating a class of forbearance that ends up exacerbating the problem as we go down the road. We're paying a goodly share of this thing and I think the time for forbearances has passed.

The **Chairman**. Senator Pressler, did you want to say anything further to that point?

Senator **Pressler**. No, Mr. Chairman.

The **Chairman**. Let me ask you this. Mr. Koch, you indicate that your particular institution is doing pretty well these days. You've got a very high capital standard. You're above the 6 percent. You're profitable. In fact, if I understood you right, your profits are actually rising right now, that you've managed to manage your business successfully in that sense.

I believe I also heard you say that about 70 percent of your activity is in mortgage lending activity. Did I hear that also correctly?

Mr. **Koch**. Yes.

The **Chairman**. Now you're based in Ohio, so your service area is principally Ohio?

Mr. **Koch**. Ohio.

The **Chairman**. So you're in the upper Midwest, and you've managed with 70 percent focus on housing to do very well in spreading your other activities that you're involved in in that particular operating area.

Do you think that if we were to establish a qualified lender test of 70 percent for all federally chartered savings and loans with a sensible and balanced 30 percent residual—and that is open to discussion and judgment as to exactly what ought to constitute the range of related activities—one institution might want to concentrate more on one aspect of that additional group of activities and another one might want to move in a different direction—credit cards, you mentioned, or car loans or whatever it happens to be.

Do you feel that a 70-percent test would be something that the institutions that you deal with could continue to be profitable and raise capital on that kind of a concentration level?

THE 70 PERCENT TEST

Mr. **Koch**. I'll answer as representative of the National Council. I think that 70 percent is a bit on the high side. I think we currently have a test of 60 percent if I'm not mistaken.

The **Chairman**. Why isn't it on the high side for you?

Mr. **Koch**. Well, my particular institution, as I say, qualifies under the 70-percent test so I'm not sure that it's terribly relevant for me. Where it becomes relevant is that we do have——

The **Chairman**. Well, no, but it becomes relevant for me and I'm posing the question because if you've managed to do it quite successfully at 70, then why can't others?

Mr. **Koch**. Well, we have quite a few savings bank institutions in this country that are either Federal savings banks or State-chartered savings banks. These institutions are well-capitalized. They are extremely profitable. Their focus has not been traditionally 100 percent on housing. Of the 21 FDIC, federally insured, Federal savings banks, the average percentage they have in their assets today is 62 percent. So there are some other institutions that for various reasons are somewhat lower.

The **Chairman**. Well, let me just say respectfully, we are here looking at the savings and loan industry. We are looking at the FSLIC fund. I'm conscious and sensitive to the cross-relationship to other kinds of institutions that are similar but different. And we're talking about how we take and restructure and reform and stabilize the savings and loan system. So let's just stick with that for the moment and then we can sort of deal with sort of related kinds of institutions.

Let me ask you, Mr. Beeksma, can the savings and loan industry, the part that you represent—can it be profitable and attract capital on a 70 percent qualified lender test?

Mr. **Beeksma**. Mr. Chairman, we think that the present QTL test and our present position is defensible, but——

The **Chairman**. That's not what I'm asking.

Mr. **Beeksma**. I understand, but let me go on to respond to your specific question to say that the 70 percent QTL test I think would be an issue that we could probably sell to our business, assuming we had some flexibility to decide and define what is included within that and what the remaining 30 percent allows. I think there's some flexibility there. In other words, the test of what qualifies now perhaps could be assessed and decided and have we got all the proper categories in there, but we certainly feel that that's something that's open to discussion. We'd be happy to carry that on with you later.

The **Chairman**. Well, that's a constructive response. As I looked down the list of States in the country that have the majority of the holdings of the savings and loans within their States at 70 percent or higher, it's a very substantial number. Now that doesn't mean that every single S&L in those States is above 70 percent, but it certainly would indicate that the majority are.

Now I would like to ask both of your organizations—Mr. Koch, in your case, I want to just look at the S&L aspect of this now. I would like a response in writing from both of you in advance of discussions that if we were to work off the hypothesis of the 70 percent qualified lender test, I would be interested in your respective views as to how the 70 percent be defined. You make the point that you'd like to think about how precisely that's defined, and I think that's a fair point.

I would also like your suggestions as to what would constitute sort of the wraparound functions if we were talking about a 50-State uniform charter to cover the additional 30 percent of activities. I would like both of you to give a response in writing as to what would constitute a good blend, a sensible, related sort of blend of activities that you would wrap around a 70-percent qualified lender test. I'd like to get that from you in writing. I think it would be very helpful for us to get that. My time has expired. Let me yield to Senator Garn.

Senator **Garn**. Mr. Chairman, as I indicated, the rest of my questions were for a response in writing.

The **Chairman**. Very good. Senator Bryan.

Senator **Bryan**. Just as a followup to the chairman's question, Mr. Beeksma, what percentage of your portfolio is in home mortgaging and related activities?

Mr. **Beeksma**. Of our total investment portfolio, lending portfolio, about 70 percent is in one to four family residential mortgages. The remaining 30 percent is divided between other kinds of mortgages and consumer loans.

Senator BRYAN. I guess I'm struck with what appears to be a bit of a dichotomy in the testimony. As we've heard witness after witness appear before us, it would seem that those savings and loans which have weathered the economic storms are those institutions which have, as we've heard here, stick to their knitting. They've been involved heavily in the home mortgage lending operation as opposed to some of these more exotic investment opportunities that apparently some of the State-chartered institutions have embarked upon.

And yet I hear you, Mr. Koch, indicating that you've got to retain the flexibility. Is it flexibility above the 70 percent?

Mr. KOCH. I guess my concern is somewhat different. Let me give a theoretical example. If I were to get together a group of investors and come up with, say $10 million or $5 million, whatever the current requirement is, and decide to start a de novo institution that's primary purpose in life would be to make single family one to four homes, if the administration bill is passed as proposed, I would recommend strongly to those investors that they get a national bank charter and do that function under the national bank banking type provision. I believe that we are watering down the thrift charter to a point where it's not only not attractive any more, I think it's downright unattractive. All the things that are important in the charter that makes the charter attractive today are going to be under very serious attack and I think those theoretical investors would be better off operating that nitch for home lending under a commercial banking side. And that's a terrible reality that we're facing with this proposed bill.

Senator BRYAN. Well, specifically, what is it in the administration's bill—as I understand it, the administration's bill retains the 60-percent criteria. Hopefully, it will be sufficiently specific that we will not permit the circumvention which I believe was allowed to occur in the old system, but what is it in the 60-percent criteria that's proposed in the administration's bill, focusing your answer if you will, Mr. Koch, not on the other things that you all have talked about in terms of your perceived inequity in dealing with you banking competitors, but in terms of the primary function of the savings and loan institution, at least as many of us in this committee would prefer to see it?

Mr. KOCH. In relationship to the asset flexibility, the power that you have, the ability to invest in, I don't think we have any quarrels with the bill. It's the other things that concern us that add cost to the institution that brings in the question whether you should be a thrift or a bank doing the same function.

Senator BRYAN. Mr. Chairman, I yield the rest of my time.

The CHAIRMAN. Senator Shelby.

Senator SHELBY. Let's try to get to some dollar figures. We talked about credibility earlier. We talked about your credibility 2 years ago, $5 billion, $15 billion. Let's take the $15 billion. If we took the high figure, it was way off.

Where are we today as far as projections of costs in the I call it two-phased bailout? The first phase is when we're going to close the ones that are already insolvent. Second, down the road—and it might be sooner than later—when a lot of these thrifts don't meet the capital requirements, we're going to have to take another hit.

And who's going to do it? The taxpayer? Maybe the institutions that are left or a combination?

We've seen figures before this committee, some not as low as they used to be when we'd come in even last year. I want to know from each one of you what is—talking about both phases, the current phase of insolvencies, what it's going to cost, and the second phase. I know it's a projection. As Dick Darman said in here the other day, he had not arrived at those figures exactly in a linear fashion and we know you haven't either, but having that in mind, let's talk about exposure. Is the hole so deep that nobody can fathom it at this moment? What are your figures?

COST PROJECTIONS

Mr. **Beeksma**. Senator, if you would allow me, I'm reluctant to put figures on it for this reason.

Senator **Shelby**. Why?

Mr. **Beeksma**. I understand your predicament, that in the legislative process you have to deal with numbers so you know how big a hole to fill.

Senator **Shelby**. That's right. But those numbers bring credibility not only to us but to you.

Mr. **Beeksma**. I understand. The reality of it is that the number changes every day and if we had the capacity to assess what it really would cost today——

Senator **Shelby**. Put a high figure and a low figure. You're in the business. You speak for your association. But let's say you speak for yourself, just a judgment call. Is it going to cost at least $200 billion to bail out the thrifts on both phases? Would that be a high figure or would that be a realistic figure?

Mr. **Beeksma**. Let me underscore this. If the process of resolution and disposition of assets is properly managed and extended over a reasonable period of time of 4 to 5 years, we think that the size of that problem ultimately will prove far less than what many of the higher numbers indicate.

Senator **Shelby**. Like what? What's far less?

Mr. **Beeksma**. Well, it probably should be within the $100 billion range.

Senator **Shelby**. $100 billion.

Mr. **Beeksma**. If it's properly managed.

Senator **Shelby**. There's a contingency there. But could it go as high as $200 billion?

Mr. **Beeksma**. It could go to a trillion if it's improperly managed.

Senator **Shelby**. That's right. And if a lot of things don't work.

Mr. **Beeksma**. Right.

Mr. **Koch**. I also will submit it's a moving target. Today we think the number is easily in excess of $100 billion, so that would be the low side.

Senator **Shelby**. That would be lowballing it, wouldn't it?

Mr. **Koch**. That would be the low side. You asked for a high and a low. I don't think we have a high side, but we are quite convinced that you are looking at a minimum of a $100 billion problem and moving north fast.

Senator **Shelby**. North fast, by leaps and bounds.

Mr. Gray, do you have any comment? Your comments earlier were quite to the point.

Mr. GRAY. I won't turn down an opportunity to act like a living thing this morning and speak.

The bulk of these losses were produced by outright fraud. There is no way to make nothing but bad loans and not know you're making bad loans at the time.

To the extent that the remaining thinly capitalized companies find their capital exhausted, you will find that they have—for every $100 of deposits, they have roughly $100 worth of assets, no capital, no more assets than liabilities.

Senator SHELBY. So a lot of them are going belly-up that we're not counting?

Mr. GRAY. The companies that have produced the loss have assets worth 45 cents on the dollar of liabilities or 20 cents on the dollar of liabilities. There are examples of companies with $500,000 in net worth, sir, and $11 million in assets that in the ensuing 18 months acquired $800 million of deposits and destroyed them making loans on windmills. Where were the bank examiners? That loss at one company in northern California—it wasn't in the energy patch—was 25 times the national budget for supervision, examination and enforcement in the entire country in the year in which the loss occurred. At one company in Texas, at Sunbelt Savings, the loss would have paid for 250,000 bank examiners. We had 1,400.

The doors were left open on the banks unlocked. The vaults were not closed. There were no policemen for decades. That's why there's money missing.

The banks make loans on all kinds of assets. The banking system is in fine shape. The savings banks make loans on all kinds of properties. They're in fine shape. There are policemen. There are bank examiners.

And you could take this one step further. You could actually apply what the insurance industry knows about managing losses. You could actually apply that to financial institutions. Fannie Mae and Freddie Mac guarantee a $½ a trillion of mortgages and they have no losses. Why? They underwrite. They look at one loan out of every 40. They visit a company once in a while to see if they meet the underwriting principles.

Senator SHELBY. And the hospital orderlies aren't doing brain surgery.

Mr. GRAY. This has been mismanagement on such a fundamental level.

Senator SHELBY. What's your high number and low number?

Mr. GRAY. Well, all right, let's talk about that. Let me ask you a question, sir.

Senator SHELBY. I'm asking the questions.

Mr. GRAY. All right. Well, to begin with, whatever the cost is, it's the cost today. It's not the interest cost computed to the next geological age. Why is the debt being raised to finance this rather than the debt being raised to any other expenditure being made at the Federal level? Do we take the defense budget today and impute a 9-percent interest cost in perpetuity? No. The loss is huge. It's an obscenity. But there's no way around it. The deposits are gone.

Senator **Shelby**. We understand that, but what's your number? You said it was huge.

Mr. **Gray**. Well, I would say that for—I would guess it's on the order of $75 or $80 billion and that is the difference between deposits on which companies pay interest and assets on which they earn interest. It's the difference between your mortgage and your savings, if you will, if you were an institution. I'm assigning no value to the buildings, no value on anything on which they do not earn interest, and I charge them for no liabilities except those on which they pay interest. There's $70 billion more deposits than interest-earning assets. It costs the industry $5.5 billion a year to pay interest on deposits that are invested in air—fictions made up by the regulator or the accounting profession called good will.

Senator **Shelby**. Your figure is the lowest one I've heard.

Mr. Rosen, do you have a figure?

Mr. **Rosen**. Yes. I think the number, if managed properly, could be below $100 billion because there really are these assets. Half the assets are in the energy States.

Senator **Shelby**. Now you're not the same people that came before us 2 years ago and talked about $5 billion?

Mr. **Rosen**. I'm a professor. I'm just giving you my honest opinion. I'm not representing the League. I'm a real estate professor and I know half of them are bad assets in the energy belt which needs to be——

Senator **Shelby**. You don't think it could go as high as $200 billion?

Mr. **Rosen**. I think it could go to $200 billion if you don't stop them right now from doing things that are highly risky. I think that's the biggest problem and the door is not closed.

Senator **Shelby**. And it's going on right today?

Mr. **Rosen**. I think it's still going on today.

Senator **Shelby**. Mr. Chairman, thank you for your indulgence. My time is up.

The **Chairman**. Senator Shelby, that's important questioning. We're going to try to close the door on some of those risky activities that are causing those losses to mount.

I do think there's an important point here about the degree to which the structure of the reforms—the bearing that will have on whether this middle group of savings and loans has a chance to get healthy or whether in fact we've put them in a position where there's going to be a backward slide and they become in a sense insolvent thrifts later on. I think we want to try to minimize the cost in the future in every way we can and so that's an important part of designing this structure properly.

It seems to me in terms of the loss side of it the losses are going to be very substantial and the other day we were talking about whether or not there should be any cap put in the law as to how much money can just automatically come out of the Treasury to cover these losses in the future. In effect, the administration's proposal, if we enacted it exactly as it is, in a sense, signs a blank check for the future and if the figure turns out to be $100 billion, then the part of that the Treasury would pay would just automatically flow in order, and if it was $150 billion the same thing.

I think we've got to find some way to keep some measure of control over what those outer numbers look like, particularly because those additional costs that may arise in the future have to be handled on budget under the Gramm-Rudman-Hollings discipline and so if we were to find, for example, that the hit to the Treasury is larger than it's being anticipated now, it not only is the difficulty of finding that money, but the way it plays back over into the budget you'd literally have to take that money from something else unless there was some new source of revenue found and other programs in the budget, whether it's Social Security or education or whatever else it might be, defense, would have to be cut in order to produce the money to pay for the growing size of the S&L problem in the future. That's a very serious and important contingent liability for the future that I think we can't let ourselves lose sight of.

But let me ask you this related to that. Both of you have criticized the administration's proposal for placing too great a burden on the healthy part of the thrift industry in terms of coming up with the money to in effect pay for part of the solution here.

If in fact you feel that the industry is being asked to pay too much, what alternative methods could you recommend to us for funding the proposal if you were to pay somewhat less?

ALTERNATIVES FOR FUNDING THE PROPOSAL

Mr. BEEKSMA. Well, Mr. Chairman, of course our alternate proposal is that we think that the Congress ought to access the future premium flow to a combined fund. I think that really is not far off of the Council's position in that they suggest that it be allowed to go into that.

The CHAIRMAN. Yes, but what that means is you would ask the banks then to chip in to pay for part of this problem; isn't that correct? The FDIC-insured institutions, is that what your answer is?

Mr. BEEKSMA. That's correct.

The CHAIRMAN. So you would have them pick up part of the tab.

Mr. BEEKSMA. That's correct.

The CHAIRMAN. Anybody else?

Mr. BEEKSMA. Well, there are lots of other sources that could be identified, but we are not prepared to put a finger on any.

The CHAIRMAN. Why is that? It seems to me that if you want to pay less yourselves or feel that you can't afford to pay as much as you're being asked to pay, you're going to have to suggest where the money comes from.

Mr. BEEKSMA. Well, at this point we can't suggest anything beyond what we have in the testimony, meaning for every suggestion that's made, of course, there is an argument why that's inappropriate and I don't know whether we have time to get into that today. I would prefer not to identify them for you today.

The CHAIRMAN. It's not a happy circumstance, but I don't think it's sufficient to come in and say, look, you're asking us to pay too much, and you put a rationale behind that, and I think it's an arguable proposition that you're making; but if in fact the logic were to be accepted by the committee as to why you shouldn't pay as much as you're being asked to pay, then somebody else is going to have to pay that part of it. Then I think there's an automatic obligation for you to have to give us some sense as to where you think we go to get that money.

Mr. BEEKSMA. Let me respond, Mr. Chairman, by saying our proposal is that we will pay as much as we think is reasonably possible and allowable under the need to acquire capital.

Second, we are suggesting the merger and the commingling of the future premium flow in the funds and we think the combination of those two will result in a lesser cost to the taxpayers than the administration bill.

The CHAIRMAN. Mr. Koch, do you have any ideas as to who might be asked to pay the amount that may seem excessive to you under the plan?

Mr. KOCH. Well, I think you just said it. Unhappily, there's not a lot of sources out there. It's clear to us that if you put the burden so high on FSLIC-insured institutions that all you're doing is increasing the cost to the taxpayer in the end.

The only source that we've been able to identify is to get more private capital. I hate to keep on coming back to it, but private capital that is attracted to the industry will require that the Government write a lesser check out for a given insolvent institution if things are put in place that make it attractive for that individual to invest in that institution. If it's not put in place, he's going to ask the Government for more money. You'll still get people in there, but the check that the Government writes for the specific institution will be greater than it otherwise has to be.

That's the only place where we can reduce the cost for all of us on a somewhat easy matter. It's kind of nebulous as to how much we can reduce it. It's impossible to tell, but the two things that we understand very clearly are that is a source of potential cost-savings and, second, it's unproductive to make the fee so high to the FSLIC institutions that we just write more of them into bankruptcy.

The CHAIRMAN. Well, I think that is a fair comment, but if we were to find ourselves passing the administration's program as is, and most of the costs that fall back on the savings and loan industry—where else, given the notion or hypothetical that we're going to pass their program as is—where else might you go to get the money?

Mr. KOCH. I think that becomes very political in nature. There are plenty of oxes that can be gored in this thing. We've got competitors out there that are money market funds, for instance, that I suggest have de facto deposit insurance that aren't paying insurance. I am not suggesting that we go after the investment community to start charging premiums on the mutual funds, but short of taking on big battles with other entities, I think we pretty much know what we have out there as potential sources. I said in the beginning you've got the institutions, you've got the taxpayer. In between you've got private investment that can be brought in.

The CHAIRMAN. Now one rationale for placing the Federal Home Loan Bank System under the Treasury Department—and this has been advanced by the administration in their program—is to break up what they describe and I think others have described as a historically close relationship between the industry and its regulator.

I'm wondering what specific suggestions either of you have for ensuring that in the future the insurer, the supervisor and the regulator are truly independent of the industry? Mr. Beeksma, what are your thoughts on that?

CLOSE RELATIONSHIP BETWEEN INDUSTRY AND REGULATOR

Mr. BEEKSMA. Mr. Chairman, thank you for that question because I welcome the opportunity to respond.

It is not fair to characterize our position as not endorsing any changes. We are endorsing a lot of changes in the regulatory structure. We are resisting the affiliation with Treasury and I think there's substantial congressional support for our position in that we have at this present time a separate Federal Reserve System, a separate Farm Credit Board, and a separate Credit Union Administration similar to the Federal Home Loan Bank Board.

Those entities have all been preserved from Treasury by Congress in years past for justifiable reasons.

As far as the Bank Board itself is concerned, my testimony I think suggests that——

The CHAIRMAN. Let me just stop you there if I may and I'll give you time to answer that question as fully as you wish, but I understand the point that you've just made.

Now how do we ensure going the other way, that there is a sufficient separation and degree of independence of a freestanding Federal Home Loan Bank Board from the industry?

Mr. BEEKSMA. Let me defend the Bank Board from this perspective. It has been subject to influences from both sides. In other words, it's had heavy influence from the business as well as from Congress. I think the record shows that there has been considerable involvement by certain congressional representatives in the regulatory process. So we're saying that that entity needs to be insulated from both sides. We're suggesting an expanded Board with longer terms and a higher degree of independence accorded to that board. There are many times, for example, in my history in this business where we've operated with one and more often two Board members out of three, so we really have never been able to have a Board which has continuity, professionalism in office and so forth. We need to have more independence and continuity at that Board, more professional status. A good example would be the Federal Reserve System. And then give them the authority and encourage them to exercise it as they should have in the past.

The CHAIRMAN. Do you have a specific recommendation to make in that regard?

Mr. BEEKSMA. We have a recommendation to expand it to five Board members with 10-year terms and maintain independence and have them have oversight of the regulatory function, the supervisory function and the chartering function, and the insurance would then be in the FDIC.

The CHAIRMAN. Mr. Koch, do you have a response to that. I know this is of great interest to Senator Garn, too.

Mr. BEEKSMA. Could I expand on the answer later if you have time?

The CHAIRMAN. Yes, we will give you a chance to do that.

Mr. KOCH. There's no easy answer to this one either. I think that we were treated to some excerpts from former chairman Gray earlier and I believe Barron's this past week had some very interesting excerpts again from former Chairman Gray concerning the interference that former Secretaries of Treasury have had on that Bank Board.

We support the separation of the insurance agency from the regulatory process. We have not opposed the administration's plan of moving the Bank Board under Treasury. We share some concerns that they in fact will not be unduly influenced by a different set of people, but I think our position is that there are other things on this bill that we are very concerned about and if the powers that be, if the administration thinks that will help solve the problem, we don't have a better suggestion so we're not opposing that suggestion.

The CHAIRMAN. Senator Garn, I don't know if you want to get into this discussion. Mr. Beeksma wanted to elaborate on his answer.

Senator GARN. Well, I will for a moment because I think we need to know or everybody needs to know that the regulator is not going to stay as is. That is a given. It's going to change. The question is, how do we make it truly independent? I don't think there's any doubt, the evidence is clear that past Boards have had too much industry influence—have had too much influence from Congress. That needs to be stopped.

So the real challenge we have is to create an independent regulator. That doesn't mean we have to put it under Treasury. I'm accused of taking the League's position on this issue. I have a lot of disagreements with some of your positions. We happen to agree on this. I came up with my opinion before I knew what yours was as the League, and you can go back to the Hunt Commission, and the Fine Study for support of my position. There's a broad history over the last decade and a half of recommendations from these independent groups that have said, "take the Comptroller of the Currency away from Treasury because you can show political influence there".

It seems to me that we do want an independent board that is not being influenced unduly by any particular group and, to me, you do not guarantee that by putting it under Treasury. Treasury secretaries come and go. I told Nick Brady a couple of weeks ago that I wasn't worried about him, but Nick Brady is not always going to be around. And the term I use, the gnomes of Treasury, still will be. It doesn't matter who a new President is or who a new secretary is, they are minor irritations to those people that have been at Treasury at least back to the time when I still had hair. And that's a long, long time.

So I see that it is more difficult to make it independent if you put it under an agency of the Federal Government where there is still the possibility of political influence, especially with evidence of that influence happening in the Comptroller's Office before.

So that's my position. I appreciate the chairman giving me the opportunity to make that point again. When we finish this legislation, we must devise a board, in whatever form that finally takes, that is truly independent; but I don't happen to think that putting it under Treasury helps solve that problem.

The **CHAIRMAN**. Mr. Beeksma, you asked to elaborate further and I said I would give you a chance to do so.

Mr. **BEEKSMA**. I appreciate that. You have to understand that the basic supervision in our business occurs in the 12 regional banks. The supervisory function is there. It has always been there, but it was changed several years back when the examination force and supervision was actually put under the banks—and that was because of OMB constraints and cost considerations. There has been a dramatic improvement in the quality of that supervision over the last 3 to 4 years as a result of that.

Let me emphasize that the administration bill says that that responsibility will be taken back and will report directly to the Federal Home Loan Bank Board in Washington. We support that. We have no quarrel with that. That's not because we think there's a fallacy in the current system, but we think that makes sense under this contemplated structure.

That would leave the regional banks involved primarily in the banking arena and the local boards could govern that aspect of it and not have involvement in supervision. As a practical matter, they have not been. I have been on the Seattle Board for 5 years and we have not had any involvement in the supervisory process. We are specifically excluded from that. But that arrangement under the Bank Board and independence, we would support. We think that's a viable move and leave the regional banks involved in banking related activities.

The **CHAIRMAN**. In addition to the other specific requests I made to you which are very important and which I would hope we could have by the end of the week, I would like each of you to give us in writing any specific changes that you would want to recommend to the administration's proposal for structural and regulatory reform of both the Board and FSLIC.

In other words, I'd like you to delineate specific adjustments that you both would seek, but I want those in writing and to the extent that that carries over into the 12 regional banks, I'd like that also. So we really have your sense for the reaction to those structural adjustments in that area.

We're going to have some other questions for the record for both of you from myself and from other members of the committee.

Mr. Rosen, let me just say one thing to you. That is, of course, you and Mr. Gray were not invited witnesses today. You are here along with the U.S. League attached to them today.

But you at one point made a comment about sort of your vantage point and impartiality, and isn't it also the case, in addition to your teaching at the University of California, don't you at the same time also have an affiliation with Salomon Bros. of some sort?

Mr. **ROSEN**. I'm a consultant to Salomon Bros. and I'm also a member of the board of directors of World Savings and Loan, which is one of the very healthy institutions in California.

The **CHAIRMAN**. Very good.

Senator Garn.

Senator GARN. I would just make my broken record closing comment. Once again—in every hearing—it doesn't matter what the subject of the hearing is, we always get back to peoples' estimates of the size of the problem. I guess nearly 3 years I've seen that the size of the problem isn't nearly as important as getting on with the solution. In 1986 the chairman then helped me get $15 billion of FSLIC recap through the Senate, which the League opposed at that time. If we had gotten that amount at final passage, we wouldn't be having the tough types of hearings we're having today. It wouldn't have solved the problem, but it would have been a great deal smaller than it is, if we had had that $15 billion unrestricted FSLIC recap.

The point I want to make, is that when we play these numbers games, the only estimate that even comes close to the current hole is in the $75, $80, $90 billion range. When we go beyond that, I don't care whose estimate it is, it seems to me a little bit ridiculous and not productive to try and guess what the 25 or 30 year cost will be when I can't tell you what the prime rate will be in July 1989. It is impossible. I can't believe that—here we are serious minded people on both sides of this table—to continue to debate whether it's $200 or $300 billion when it is absolutely impossible to determine, as Alan Greenspan said, unless you can tell me what the interest rates will be every month for the next 30 years.

So we obviously all agree that there's a problem at least in the $100 billion range. The point I want to make very strongly, which both the chairman and I have made over and over again, is that enough delay has gone on. It is time to enact something. The worst plan we could devise is better than no plan at all because the longer we talk about it and the longer we argue about it, the bigger the problem will be. That is one thing that I can guarantee you. We can create self-fulfilling prophecies. We can make it a $500 billion problem just by continuing to do nothing as we have done for the last 3 or 4 years.

So if the President's plan has got warts or there are some things the chairman and I disagree with, or you disagree with, we'd be better off to enact it today without one single change than not to do anything.

I hope that somehow we can get the message across of how important it is that this Congress act as rapidly as we possibly can with whatever plan we can come up with, because a bad plan is a lot better than doing nothing as we have been doing.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you, Senator Garn. I hope that you and I share the same sense of urgency on that, as you say, and I would hope that we could move fast and have a good plan. That's certainly our intent.

I want to indicate for the record, the last year for which we have the data available and totaled, is 1987. In 1987, looking at a list of the 50 States, totals State by State, 28 of the 50 States or obviously more than half had—the savings and loans in their States had 70 percent or more of their assets in home mortgages or in mortgage-backed securities. Again, looking at all the States, those that would have had the savings and loans in their States about 65 percent add up to a total of 43 of the 50 States. Only 7 of the 50 States were not as high in total as an industry as 65 percent.

So I think what that demonstrates, especially when you look at the regional character of most of the disaster that we see in the problem and the character of the S&L's that have lost the greatest amount of money, that the home lending business has worked very, very well for a lot of other S&L's, including some represented at the table today and others that we have heard from. But it seems to me that something in the 70 percent figure area is entirely reasonable and sound given the fact that the whole justification for this specialized industry is to meet a particular national need, albeit with enough additional operating latitude to be able to be profitable, to attract capital, to go ahead and meet that public function, as Senator Sarbanes described it earlier.

You wanted to make one final comment and then we're going to adjourn here.

Mr. BEEKSMA. I just wanted to say, Mr. Chairman, how much we appreciate the courtesy that you and your associates have accorded us. We realize your frustration with this. We don't enjoy it either. I've done this several times and it's not been fun, but we appreciate your courtesy.

The CHAIRMAN. Thank you.

The committee stands in recess until tomorrow.

[Whereupon, at 12:55 p.m., the hearing was recessed, to be reconvened at 10 a.m., on Wednesday, March 8, 1989.]

PROBLEMS OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION [FSLIC]

PART III OF IV

WEDNESDAY, MARCH 8, 1989

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Cranston, Dixon, Shelby, Graham, Bryan, Garn, Heinz, D'Amato, Bond, Mack, Roth, and Pressler.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The Chairman. The committee will come to order.

I want to welcome our witnesses here this morning.

Today is our 12th hearing on the problems facing the savings and loan industry and its insurance fund. Yesterday, we heard from the U.S. League and the National Council representing the thrift industry. Today, we will hear from representatives of the American Bankers Association, the Independent Bankers, and the Financial Services Council.

Some of the key issues that the committee has been reviewing include the future nature of the thrift charter, the role of Federal deposit insurance as it relates to State-chartered institutions, the independence of the newly created thrift insurance regulators, ways to break up the historically close relationship between the regulators and the thrift industry, and the adequacy of the Treasury's financing proposal.

Of particular concern to our witnesses this morning are the issues of a separate versus common insurance logo, as well as a continued separation of the funds themselves.

We look forward to receiving the views of our witnesses on these subjects as well as any other reaction favorable or otherwise, that they have with respect to the administration's proposal.

Finally, the Consumers Bankers Association was invited to testify this morning. They asked instead that they be permitted to submit a statement for the record and their statement will be included in the record.

[Committee insert of Consumers Bankers Association's statement follows:]

CBA
CONSUMER BANKERS ASSOCIATION *The Association for Retail Banks, Savings & Loans and Credit Unions*
1300 North Seventeenth Street, Suite 1200, Arlington, Virginia 22209-3880 703/276-1750

March 17, 1989

The Honorable Donald Riegle
Chairman
Committe on Banking, Housing
  and Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Riegle:

Enclosed please find the Consumer Bankers Association's statement on S. 413 and various issues concerning the plight of the FSLIC. We very much appreciate the opportunity to submit for inclusion in the Committee's hearing record the views of our Association and its more than 900 member institutions.

The problems of our nation's thrift industry and its insurance fund are among the most urgent and challenging facing the 101st Congress, and CBA commends you for tackling this issue head-on. As Congress and the Administration move toward a solution to the enormous problems surrounding the FSLIC, we look forward to working with you and your staff. Please do not hesitate to call me if we can provide additional information and assistance.

Sincerely,

Joe Belew

Joe Belew
President

STATEMENT OF
CONSUMER BANKERS ASSOCIATION
BEFORE THE
U.S. SENATE COMMITTEE ON
BANKING, HOUSING & URBAN AFFAIRS
MARCH 8, 1989

The Consumer Bankers Association is pleased to submit this statement on S.413 and various issues surrounding the plight of the FSLIC. Because CBA's membership consists of both banks and well-managed thrifts, we have a unique perspective on this and other issues affecting the financial services industry. CBA was founded in 1919 and represents the retail interests of some 800 federally insured financial institutions around the United States.

In general, we are supportive of the Bush Administration's plan. We are firmly of the view that speedy consideration is in order and that delay will be costly to our industry and to the taxpayer. We support appropriate regulatory reforms aimed at preventing future fraud and abuse. At the same time, we think such stronger regulatory oversight is in no way incompatible with future modernization of the financial services system. We will not insist or even suggest that such modernization be part of the FSLIC solution, but neither should the thrift crisis be used as an excuse to oppose future structural reform.

Need for Action

Few problems confront the 101st Congress with as much urgency as the current crisis in the deposit insurance system. While estimates vary on the total size of the FSLIC deficit, there is no argument that the government's obligation continues to increase dramatically for each day the problem remains unresolved. Interest costs alone on the borrowings used to finance the rescue will cost at least $10 billion a year -- on top of the $100 billion price tag already before us. In the month since the President first laid out the outlines of his plan, its price tag increased almost $1 billion.

Every interest group looking at this complex proposal will want something special from it. Any vital piece of legislation which must be passed is seen by some as a locomotive for other issues. The Consumer Bankers Association believes that it is also critical that we modernize our financial system, but we do not seek to add such provisions to this bill. We believe the public interest is best served by rapid, bipartisan, and policy-oriented action on the President's package. After quick resolution of this crisis, we urge Congress to turn to permanent reform and restructuring issues.

Support for Administration

It is clear testament to the importance of the FSLIC rescue that the new Administration made this its first policy initiative. Barely two weeks after his inauguration, President Bush asked Congress to act

on a balanced program of new financing and regulatory changes, both essential if the FSLIC crisis is to be meaningfully resolved. As noted the Consumer Bankers Association supports the structure of the Administration plan, although our statement will suggest some areas which might be improved. Most importantly, however, we would like to commend the President and the regulatory agencies for developing a credible solution to a pressing problem.

Regulatory Reform

One of the most critical aspects of any response to the FSLIC crisis is a program of regulatory changes which ensure that no similar crisis recurs.

CBA represents both banks and thrifts and focuses specifically on retail banking services offered by these institutions. Because of this, CBA is perhaps most keenly sensitive to the concerns being voiced by the average consumer of financial services around the country at all types of financial institutions. Our members, like their customers, are appalled by some of the recent revelations about fraud and abuse in the financial system. We cannot urge too strongly that the regulators be given the tools adequate to move against those who defrauded the system and to prevent such abuses in the future.

We support much of the restructuring of regulatory responsibilities proposed by the President's plan. The FSLIC has lacked the resources and ability in the past to supervise the institutions it insures. We believe the combination of the FDIC and FSLIC examination and supervision resources would be better structured to perform this task, and thus support the administrative merger of the two agencies already underway.

Our members also support more scrutiny by bank and thrift regulators before an insured depository is chartered. We take the responsibilities of our government charter seriously, and do not believe it should be available to those with previous criminal records or mismanagement experience.

We also support a transfer of the Federal Home Loan Bank Board into the Treasury Department. The long history of successful operation of the Office of the Comptroller of the Currency as a bank regulator and Treasury agency indicates that this structure will work. We believe that the Federal Home Loan Bank will remain responsive to thrift industry concerns when it becomes a Treasury agency, but that it will also be better isolated from some of the pressures which have impaired its effectiveness in the past.

We believe, however, that the relationship between the OCC and the FDIC might be the model for the newly formed partnership of the FHLBS and the FDIC. The current proposal appears to suggest a different structure.

Accounting and Capital Standards

Because the CBA represents both banks and thrifts, we offer a unique perspective on issues of regulatory structure affecting both industries. We believe strongly that capital accounting and regulatory standards should be applied equally to all insured depositories. Without strict adherence to meaningful standards, the public will have no reason to believe that its insured depositories are being carefully managed and properly supervised.

Such an environment of regulatory parity between banks and thrifts is essential to reform of the financial system. Institutions which meet their public responsibilities of maintaining good accounting standards and adequate capital should not be forced to compete against institutions allowed an undue amount of flexibility. Long years of experience have taught us that there is simply no substitute for rigorous accounting and audit practices, and we support the movement of thrift accounting standards to generally-accepted accounting principals as quickly as possible.

Similarly, CBA supports enforcement of bank capital adequacy standards for thrift institutions. FSLIC reform must provide a timetable for equality among banks and thrifts on capital.

Commercial banks have spent the past three years working with their regulators to modernize bank capital requirements, as required by the new international banking accords. Beginning this month, a new standard of capital requirements based on risk will be imposed, and banks across the country are adjusting their balance sheets, holding back on stockholder dividends, and raising capital to meet these new standards.

In addition, the FHLBS has already provided for comment, risk-based capital standards which will implement a parallel structure for thrifts. We believe that these rules will be an important step forward in increasing capital standards.

It's worth noting that the new standards make a special provision for mortgages, and thus would not -- if imposed on thrifts -- require as much new capital as they will for banks. The new standards apply a risk weight of 100% for all private-sector loans, except for mortgages. Mortgage loans need only be capitalized at 50%, making this the most favored class of loans available to any financial institution. This feature of the new risk capital standards for banks and thrifts ensures that housing finance will continue to be encouraged.

However, CBA recognizes that the Administration plan, while absolutely correct in demanding capital parity, may impose bank capital standards on thrifts too quickly. Significant numbers of currently solvent thrift institutions will very likely be forced to contract radically if forced to achieve bank capital by 1991. Case by case forbearance has not served us well, but our major thrift members are concerned that the current schedule is not realistic. In addition, and in the spirit of fairness, they feel that good faith deals made last year should be honored. If this is not done, then any further attempts to attract private capital could be impaired.

Thrifts, like all other insured depositories, should only be liquidated if their continued operation poses a threat to the deposit insurance fund.

States' Rights

One of the most far-reaching aspects of the Administration plan is the realignment it proposes in the dual banking system. For years, states have permitted the banks and thrifts they charter to offer products and services specially targeted to local needs.

On the one hand this has encouraged healthy innovations. One of the best examples of a state initiative is the interest-paying NOW Account. While federal law prohibited the payment of interest on checking accounts, certain states gave their financial institutions the authority to offer interest bearing accounts (NOW Accounts) in response to both customer demand and to the financial services industries' concern that money market funds were depleting their deposit base. The innovation was so successful that Congress, in 1980, enacted legislation which permitted all institutions to offer similar accounts. We are concerned that this healthy interplay between the state and federally-chartered systems will be lost if the override of state authority is too broad.

Further, the people of California recently voted to allow banks to sell insurance. In approving proposition 103, California voters exercised a right that could be unavailable in the future. Not only is this approach healthy, but it is also safe. In fact, one of the main reasons that the FDIC withdrew its 1985 proposal that limited the powers of state-chartered banks was that it found "...no system-wide problems resulting from newly granted real estate investment or insurance powers."

On the other hand, there have been abuses of state chartered entities in the thrift industry. We believe, however, that these abuses were the result of poor supervision, coupled with fraud and mismanagement, and not the result of the state power itself.

The Administration proposal would give the FDIC broad authority to deny thrifts the use of state powers which the agency believes pose a risk to the FSLIC. Even without any change in current law, thrift regulators already have the power to block an institution which lacks the capital, management, or capability from exercising a power it cannot safely conduct.

We believe that what is needed is far more rigorous enforcement of this existing authority coupled with some enhancements in the Administration proposal. While federal regulators should not have broad authority to override state powers, they should have -- and should exercise -- authority on a case-by-case basis to prevent institutions from abusing state-authorized powers.

The Administration proposal of a federal override applies only to thrifts. This is warranted only in those instances where the powers are abused. We understand, however, that some may suggest that the same type of override be applied also to banks. We do not believe this is necessary. State-chartered banks and their affiliates now offering products and services are doing so in a prudent, well-regulated manner. There is no reason for override in this area.

We are unaware of any cases in which abuse of state-authorized power is alleged as a cause for a bank failure. Instead, the abuse of state powers has occurred in the thrift industry. In our view, this shows that the problem with state powers has not been the result of such authority per se, but rather the result of lax supervision and examination of thrifts at the state and federal level. With proper regulatory supervision and capital standards, the free exercise of state powers ensures a vital financial system which effectively meets local needs.

The Administration package includes an extensive set of new enforcement powers for bank and thrift regulators. As noted, the CBA

supports these enhancements but cautions the Congress that these powers are a major change and should be accompanied by adequate controls. We believe these will prove more than sufficient to meet any challenges to the federal financial system posed by unwise use of state authority.

Cross-Marketing Restrictions

The CBA opposes cross-marketing restrictions in principle. One of the most important consumer advantages of diversified financial institutions is their ability to package attractive financial services targeted efficiently to specific consumer needs.

We do not believe, however, that some financial entities should be able to offer more products than others. Banks as well as thrifts should be permitted to offer a broad array of new products and services without restrictions on their abilities to do so in common facilities or through subsidiaries which share a common name. However, we do not believe cross-marketing restrictions should be eased for some institutions while others are barred from offering competitively-packaged financial services. Relaxation of cross-marketing should accompany overall modernization of our financial services laws.

A further comment on cross-marketing: too often, discussion of cross-marketing restrictions accompanies discussions of "firewalls", or necessary restrictions on capital and credit flows between financial affiliates. The firewall issue is a legitimate one, but we do not view cross-marketing restrictions as related, since they concern marketing and sales rather than underwriting and credit. The Administration plan proposes an extension of current conflict of interest and self-dealing restraints for the non-banking activities of all companies which own insured depositories. We support these proposals, since the 23A and 23B restrictions are important barriers to abuse and fraud. These are, we believe, sufficient to ensure safe operation of diversified financial institutions and should not be confused with any cross-marketing restraints.

Purchase of Healthy Thrifts

The Consumer Bankers Association supports the sections of the Administration plan which would permit bank holding companies to purchase healthy thrifts. We would support such purchases sooner than the plan's proposed two-year time frame.

Permitting banks to acquire healthy thrifts now would give the FSLIC and other federal regulators far greater authority to package thrift acquisition deals attractive to bank holding companies as quickly as possible, which would provide a new source of capital for the thrift industry.

We also believe that bank holding companies should be able to operate their thrift subsidiaries as thrift institutions and to do so without onerous restrictions including those on tandem operations.

Regulatory Enforcement Provisions

While we strongly support increased regulatory enforcement and vigorous prosecution of fraud, we do have concerns with the provision in the Administration package which would add financial fraud as a predicate offense to the RICO laws. We believe that civil and criminal financial fraud ought to be punished with the strictest penalties

available. Nevertheless, the RICO statute itself has recently been used to pursue alleged civil violations which have nothing to do with racketeering or criminal organizations.

As a result, Congress is again considering legislation to reform the RICO statute itself. We believe that adding financial fraud to RICO should only occur in the context of larger RICO reform, and suggest that this provision be deleted from the deposit insurance reform package and instead be considered in some form to the RICO reform legislation already introduced by Senator DeConcini.

CBA is also concerned that several of the regulatory powers granted to the FDIC may reduce the rights of those who own and operate financial institutions without adding significantly to the safety of the deposit insurance system. We are particularly troubled by the authority granted to the FDIC to terminate a bank's insurance coverage for any violation of law or rule -- no matter how minor -- and without meaningful appeal. This could allow the FDIC to shut down banks virtually at whim. A finding of substantial harm should be required before insurance is terminated, although the FDIC should be allowed to remove coverage more quickly than currently authorized.

Deposit Insurance Premiums

In order to secure both the bank and thrift deposit insurance funds, the Administration proposes a substantial increase in deposit insurance premiums. CBA member banks and thrifts are prepared to pay a fair share needed to maintain the strength of their respective insurance funds.

However, it is vital that, as we increase the resources of the deposit insurance funds, we do not undermine the overall safety of the financial system. Deposit insurance premium basis points, when measured against an entire deposit base, are a substantial cost of doing business for all insured institutions, and impede their ability to compete with uninsured providers of competitive services and with foreign institutions.

On behalf of our bank members we are concerned with the broad grant of authority given to the FDIC to increase bank deposit insurance premiums. At the same time, on behalf of our well-managed thrift members, the proposed premiums and other costs could jeopardize their ability to remain viable and perhaps more importantly, threaten their ability to raise much needed capital.

Costs of Deposit Insurance Reform

The CBA strongly believes that, even in the face of increased bank premiums, consumers will not be noticeably affected. Premium increases will be borne by corporate customers, shareholders, and individual account holders alike. One reason CBA supports the Administration program is its balanced approach to the cost of reforming the deposit insurance system. Public policy concerns dictate a long-term, even-handed response to the FSLIC problem, which the Treasury plan generally provides. While some have suggested that higher premiums will result in significant cost increases for low-balance customers, we think the Administration plan can be implemented without undesirable costs to the average consumer of financial services. In the long run, all consumers

will benefit directly from the increased stability which this plan will create.

Modernization of the Financial System

One of the most important features of the Administration proposal is the requisite Treasury study of long-term reform. Sweeping as the President's plan is, it still leaves untouched the changes necessary if the U.S. financial system is to be restored to genuine strength, competitive equity, prosperity, and long-term stability.

Our financial system is badly misaligned. It no longer meets the needs of American consumers for diversified financial products, nor does it meet the corporate need for efficient capital formation. As a result, we fall ever further behind in the global race for financial competitiveness -- even in our own country, where foreign financial institutions are now amongst our most competitive firms.

We urge Congress to take seriously the mandate for progressive reform immediately after deposit insurance restructuring and regulatory enhancement. CBA strongly supports the regulatory changes necessary to ensure that strict capital, accounting, and regulatory standards will apply to all financial institutions. By the same token, we believe these changes will ensure a financial system which can then be modernized to keep pace with the market. Banks and thrifts should be permitted to offer the full range of securities, insurance, and real estate powers their customers seek, competing equally with other firms to offer banking services in a system which protects the safety and integrity of the deposit insurance funds.

The **Chairman**. Senator Garn.

Senator **Garn**. Thank you, Mr. Chairman. After 11 opening statements, I see no reason to give one today. In fact, what I hope to do soon is give a closing statement on a bill as soon as possible.

The **Chairman**. Very good.

Senator D'Amato.

Senator **D'Amato**. Thank you, Mr. Chairman. Mr. Chairman, I'm going to follow Senator Garn's lead and ask that my statement be introduced in the record as if read in its entirety.

The **Chairman**. Without objection.

Senator **D'Amato**. I have an Intelligence Committee meeting. I don't know if they're going to try to help me there, but, Mr. Chairman, I do have some questions for the record for Mr. Haraf, and I'm wondering if you might undertake those for me at least for the record.

The **Chairman**. We'll ask him to supply answers.

Senator **D'Amato**. I have an observation, as my statement does, over a period of time as it relates to the testimony of Mr. Rideout and Mr. Tomson in dealing with the credit unions. I read your papers—at least my staff has—I'm not going to tell you I read them, but my staff has and they have advised me of your position as it relates to the credit unions.

I wish that I had the opportunity to go into some detail with you on that, but I strongly object to the Treasury's proposal as it relates to the credit unions. They're little guys, not for profit, do a good job, and I don't think we should mix up and create a problem that is not of their making and put them into this fund. I just really don't, and that's where I'm coming from and I will be proposing amendments as it relates to that to take them out of that situation. If it ain't broke, don't fix it. That's an old admonition and I think we should spend more time adhering to that.

Thank you, Mr. Chairman.

[The complete prepared statement of Senator D'Amato follows:]

OPENING STATEMENT OF SENATOR D'AMATO

Senator **D'Amato**. Mr. Chairman, I have reviewed the witnesses' testimony and have, accordingly, some comments I wish to offer.

I wholeheartedly commend Mr. Haraf's support of the Depository Institutions Affiliation Act, an act which Senator Cranston, Senator Garn, and I introduced yesterday. The act reaffirms our commitment to a comprehensive and forward-looking reform of the current laws governing the financial industry. These are lessons we have learned from the FSLIC problems that I hope will carry over to our efforts on banking reform. Among these are the importance of true firewalls between insured deposits and riskier activities and the importance of bringing new capital into the financial services industry. Also, as we craft a thrift bill we must never forget that our goal is to let the marketplace answer the hard questions of the shape of the future financial services industry. I hope and believe that the lessons learned today will carry over to the day when this committee will again look at the still larger issues of banking reform.

I am glad that Mr. Haraf supports the Cranston-D'Amato banking bill and hope that these discussions will assist us in ultimately developing a comprehensive banking bill which attempts to ensure both the soundness of the insurance depository system and the international competitiveness of the U.S. financial markets.

On the other hand, I must take exception to one opinion shared by Mr. Tomson and Mr. Rideout. Specifically, I am disturbed by their support of the Treasury plan to exact an unhealthy insurance premium from the credit union industry. I suspect their conclusions are predicated on the notion that credit unions perform some of the same functions as a thrift or a commercial bank. But there are much bigger differences and therefore, as I have previously stated, I am strongly against the inclusion of the credit union fund in the FSLIC deficit plan.

I must go on the record again and state that comparing thrifts with credit unions is like comparing apples with oranges. Credit unions are member owned, not-for-profit financial institutions with an extremely conservative investment portfolio. They engage primarily in consumer and mortgage loans, clearly not the high-flying investments thrifts have dabbled in. Furthermore, the credit union fund has never in the past nor presently cause risk to the Federal Treasury. In fact, the credit union reserve ratio is already higher than the long-term goals the Treasury had set for FDIC and FSLIC. For these and many other reasons, I must again disagree with the Treasury's plan to treat the credit unions as if it were commercial banks or thrifts. I hope the Treasury will reconsider its position.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator D'Amato.

I have a statement from Senator Sasser to be inserted in the record.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, today we will hear from representatives of the banking industry regarding the insolvency of the Federal Savings and Loan Insurance Corporation. Understandably, the banks are concerned about the FSLIC rescue plan. Indeed, we value their input in devising a workable rescue plan because the banking and the thrift industries are inextricably linked in our financial system. The health of one will inevitably affect the continued operations of the other.

More and more, the markets of commercial banks and savings and loan institutions are overlapping. The home mortgage market has been changing since 1980. From the period of 1980 to 1988, banks have experienced a 15-percent increase in single family mortgage originations and a 32-percent increase in single family mortgage holdings while the savings and loans' share has remained virtually unchanged. With the new international capital agreement and its preference for mortgage lending, it is likely that the dominance of banks in the mortgage market will continue to increase.

The massive cost of the FSLIC insolvency is not good news. We must resolve this situation quickly and we must maintain the credibility of all the deposit insurance system. We can't allow a few bad apples to destroy the whole lot of thrifts and weaken the entire financial network. It is time to clean up the chaos in the thrift industry once and for all.

The CHAIRMAN. Let me introduce our three witnesses at this time. Mr. William Haraf, chairman of the issues committee for the Financial Services Council, who is the vice president of economic policy development for Citicorp in New York. Then Mr. Thomas Rideout, who is the president of the American Bankers Association, and who is the vice chairman of the First Union National Bank of Charlotte, NC. And then Mr. O. Jay Tomson, who is the president of the Independent Bankers Association of America, and is also the chairman of the Citizens National Bank of Charles City in Charles City, IA.

Gentlemen, we welcome you this morning. We are interested in your comments. We will make your full statements a part of the record. It would be helpful to us if you would summarize your testimony as much as you can so we can go right to the critical issues.

So let us start with you, Mr. Haraf.

STATEMENT OF WILLIAM HARAF, CHAIRMAN, ISSUES COMMITTEE, FINANCIAL SERVICES COUNCIL, VICE PRESIDENT, ECONOMIC POLICY DEVELOPMENT, CITICORP, NEW YORK, NY

Mr. HARAF. Thank you.

Mr. Chairman, Senator Garn, the Financial Services Council welcomes the opportunity to testify today regarding the administration's proposal. Members of the Financial Services Council include firms from all segments of the financial services industry as well as firms that engage in both financial and nonfinancial activities. They share a common commitment to a more competitive, efficient and fair financial services marketplace in which the safety and soundness of depository institutions is ensured.

The savings and loans owned by seven members of the Financial Services Council have almost 50 percent of the tangible net worth of the entire savings and loan industry. Council members have not contributed to the FSLIC's problems. They have been part of the solution. They would like to continue in that role.

The problems of the savings and loan industry are immediate and severe. The Council urges Congress in the strongest possible terms to resolve them expeditiously. The time to deal with this problem is now, not while frightened depositors are lined up at the doors of weak and insolvent institutions around the country.

The Council supports many of the concepts embodied in the administration's proposal. In particular, the Council strongly endorses the administration's emphasis on dealing with insolvent institutions once and for all and reinstituting meaningful capital standards for the industry.

Before I comment on this bill, I'd like to address a serious misconception that has apparently influenced this bill to some extent and has influenced other legislative proposals as well.

Deregulation did not cause this problem. Indeed, the problem can to a large extent be blamed on antiquated regulation. The savings and loan industry was in trouble long before deregulation actually occurred. A narrowly defined charter precluded savings and loans from adapting to the higher interest rate environment of the

1970's. Rather than forcing weak and insolvent institutions to raise new capital or seek a merger partner, regulators responded by relaxing capital standards to buy time for them to work their way out of the problems.

Unlike institutions with significant capital of their own at stake, these institutions had every incentive to seek out investment offering the highest potential rate of return regardless of risk.

The lesson of the FSLIC crisis is not that deregulation was a mistake, but that forbearance on capital standards and insolvency determinations is a prescription for disaster. Had capital requirements been strictly enforced and had insolvent institutions been closed promptly, there is no way the situation could have developed as badly as it did.

Forcing savings and loans back into a narrow straitjacket of mortgage lending would be detrimental to safety and soundness. The S&L industry and the unitary thrift holding company structure could be weakened to the point where they are no longer viable.

As to the administration's financing plan, ultimately the anticipated funding levels may or may not prove to be adequate. What is important is that the plan involves a substantial commitment of new funds. The administration should be commended for crafting a fair approach to dealing with a very difficult problem.

Significantly, the cost to taxpayers can be minimized by encouraging private sector participation. There is no doubt that needless restrictions on the acquisition and needless constraints on the operation of depository institutions have made it difficult to attract private capital to reorganize failing institutions.

Even more importantly, this committee must be concerned with safety, soundness and economic viability of the insured depository system over the long term. There is a critical link between a depository institution's ability to earn a healthy rate of return on its capital and its ability to survive and not be a burden on the deposit insurance funds.

To truly ensure that taxpayers' funds will never again be at risk, depository institutions will need to attract and maintain adequate capital. To do so, they must be profitable and they must have the flexibility to adapt to changing market conditions.

Several provisions in S. 413 inhibit private sector participation in the reorganization of insolvent institutions and in a sense detract from safety and soundness. I would like to consider some of them in turn.

First, this bill would require institutions that are not qualified thrift lenders to convert to banks and it would require their corporate owners to become bank holding companies. This provision would restrict the adaptability of S&L's and make them excessively vulnerable to changing conditions in mortgage markets.

In addition, this provision eliminates a potentially significant middle ground for thrift holding companies that may choose not to become bank holding companies. Eliminating this middle ground would reduce the franchise value of insolvent S&L's and increase the ultimate cost to the taxpayer of resolving this problem.

In recent years financial innovations and increased participation by nontraditional lenders in mortgage markets have provided ample funds for mortgage lending. New risk-based capital guidelines will provide further incentives for institutions to remain active in housing finance. Conditions in mortgage markets do not justify further changes in the QTL test.

Second, the bill would give the FDIC authority to restrict activities of State-chartered institutions. The Council believes that restrictions on activities are an inappropriate way to control risktaking. Instead, the Council would support William Seidman's proposal to permit State-chartered institutions to engage in broader activities in a separately capitalized subsidiary of a holding company with appropriate safeguards and firewalls.

Third, the bill would give the FDIC authority to impose liability for any losses it incurs in the resolution of a failing depository institution on other depository institutions within a holding company.

The roots of this provision go back to the FDIC's experience with certain Texas bank holding companies whose banks were operated as integrated entities. In such circumstances, the Council believes that a healthy depository institution should be liable to the extent of its intercompany liability to the failing institution. Holding companies should at least have the option to manage their insured depository institutions independently without any liability.

Fourth, the bill would allow bank holding companies to acquire healthy savings and loans without the tandem restrictions imposed by the Federal Reserve, but only after 2 years. As you know, hundreds of currently solvent S&L's will need to raise additional capital by 1991 under this proposal. To facilitate this process, the Council shares William Seidman's view that all organizations should be permitted to acquire currently healthy S&L's immediately without tandem restrictions.

Finally, the Federal Reserve has not permitted bank holding company purchasers of a failed S&L to include good will in the calculation of holding company capital. As a result, bank holding companies in many cases have not been competitive in bidding for insolvent institutions. This has unnecessarily raised the cost to the FSLIC of resolving failures. The Council believes that the treatment of good will in acquisitions deserves the committee's attention.

In conclusion, the Council would like to emphasize in the strongest possible terms that there is a critical need for further structural reforms beyond those contained in this bill. Our compartmentalized system of financial regulation is simply not working. The problems of the S&L industry are merely the most obvious manifestations. They are the first victims of the clash between the revolutionary changes in financial markets and an outdated system of regulation. Unless financial regulation is restructured, further serious problems will appear down the road.

Legitimate concerns for the safety and soundness of depository institutions justify regulation, but restrictions on affiliations between depository institutions and other enterprises are a particularly inefficient form of regulation for ensuring safety and soundness and meeting other goals.

These restrictions limit competition and reduce economies of scale and scope. They limit the ability of financial services suppliers to diversify and to adapt to changing market conditions. They prevent users from gaining the advantage of purchasing financial services from a single supplier if they so choose. Finally, they make financial markets in the United States less competitive internationally and, as a result, they drive financial activity overseas.

The Depository Institutions Affiliation Act, which was reintroduced into the Senate yesterday by Senators Cranston, D'Amato and Garn as S. 530, would give companies a chance to meet the full range of credit and financial needs of their customers in open and fair competition with other providers. It also contains important new safeguards designed to protect the safety and soundness of depository institutions and to prevent the extension of the safety net to nonbank activities.

The Depository Institutions Affiliation Act is not a substitute for the administration's plan. It is complementary. The safeguards in the bill go further and are designed to address the special issues that have been raised regarding depository institutions that are owned by diversified holding companies.

This bill relies on five distinct types of safeguards to protect the deposit insurance funds and to prevent the competitive abuses: (1) functional regulation, (2) restrictions on affiliate transactions, (3) prior review of acquisitions, (4) strengthened oversight enforcement authority, and (5) new divestiture authority.

The divestiture provisions, in particular, are extremely powerful for protecting the deposit insurance funds. Significantly, they would be particularly useful for reorganizing a large institution. None would be "too large to fail." Combined with the other safeguards, the act would virtually ensure that depository institution subsidiaries of deposit institution holding companies would not be a burden on the deposit insurance funds.

The bottom line is that this proposed legislation would enhance safety and soundness and would lower the costs and improve the quality of financial services for individuals, businesses of all sizes, and State and local governments. In the process, the productivity and competitiveness of the U.S. economy as a whole would be enhanced. Our laws and our regulations need modernization. The longer this process is delayed, the more difficult it will be to gain the advantage in a global business that is inextricably tied to our Nation's welfare.

Thank you very much.

[The complete prepared statement of William S. Haraf follows:]

SUMMARY OF TESTIMONY

WILLIAM S. HARAF

THE FINANCIAL SERVICES COUNCIL

MARCH 8, 1989

Prompt Action Is Urgently Needed. The Financial Services Council strongly urges Congress to resolve the FSLIC problem expeditiously. The Council supports many of the concepts embodied in S. 413. In particular, insolvent institutions should be dealt with promptly and undercapitalized firms should have incentives to bring their capital up to standard or seek a merger partner.

Deregulation is Not Responsible. The S&L industry was in trouble long before deregulation occurred. A narrowly defined charter precluded S&Ls from adapting to a higher and more volatile interest rate environment. The failure to deal promptly with weakened and insolvent institutions permitted a large segment of the industry to deteriorate drastically. Forcing S&Ls back into a narrow straight-jacket of mortgage lending would be detrimental to safety and soundness. The industry and the unitary thrift holding company structure could be weakened to the point where they are no longer viable.

Financing Insolvency Resolution. The Administration deserves credit for committing substantial new funds. The cost to taxpayers can be minimized by encouraging private sector participation. Every effort should be made to encourage acquisitions by responsible parties. To truly ensure that taxpayers' funds will "never again" be at risk, depository institutions will need to attract and maintain adequate capital. To do so, they must be profitable, and they must have the flexibility to adapt to change. Several provisions in S. 413 inhibit private sector participation in the reorganization of insolvent institutions and detract from the safety and soundness:

(A) Qualified Thrift Lender Test. This provision would restrict the adaptability of S&Ls and make them excessively vulnerable to conditions in mortgage markets. In addition, it eliminates a potentially significant middle-ground for thrift holding companies that may choose not to become bank holding companies, or that could not qualify as bank holding companies. Eliminating this middle ground, would reduce the franchise value of insolvent S&Ls and increase the ultimate cost to the taxpayer of resolving the problem.

(B) Activity Restrictions. Restrictions on activities of state-chartered institutions are an inappropriate way to control risk-taking. If capital standards are strictly enforced, institutions will not have the incentive to pursue go-for-broke strategies. At a minimum, the Council would support William Seidman's proposal to permit state-chartered savings associations to engage in broader activities in a separately capitalized subsidiary of a holding company.

(C) Liability of Commonly Controlled Financial Institutions. Authority to impose liability for losses incurred by the FDIC on other insured institutions within a holding company is far too broad. Healthy institutions should be liable to the extent of their intercompany liability to the failed institution. Holding companies should have the option to manage subsidiaries independently without such liability.

(D) Tandem and Cross-marketing Restrictions. All organizations should be permitted to acquire savings associations without cross-marketing and tandem restrictions immediately, rather than after two years. This will reduce the amount of federal assistance required.

(E) Treatment of "Goodwill" in the Calculation of Capital Adequacy. The treatment of goodwill in bank holding company acquisitions of S&Ls deserves the Committee's attention.

Need for Further Structural and Regulatory Reform. There is a critical need for further structural reforms beyond those contained in S.413. Our system of financial regulation is not working. Unless regulation is broadly restructured, further serious problems will appear.

Legitimate concerns for the safety and soundness of depository institutions justify government regulation. But restrictions on affiliations between depository institutions and other enterprises are a particularly inefficient form of regulation for ensuring safety and soundness and meeting other legitimate national goals. The main threat to a safe and sound banking system and to the deposit insurance funds is not greater integration of depository institutions with other services, but the continued operation of a large number of troubled banks and thrifts with little or no capital of their own at stake.

The Financial Services Council's legislative proposal, The Depository Institution Affiliation Act, would strengthen safeguards that protect depository institutions, while affording all companies equal opportunity to own them. It would promote competitive and efficient capital markets by giving companies a chance to meet the full range of credit and financial needs of their customers in open and fair competition with other financial services providers. At the same time, the proposal contains important new safeguards designed to protect the safety and soundness of the insured depository system, to prevent the extension of the safety net to nonbanking activities, and to protect impartiality in the granting of credit.

Consumers of financial services would benefit enormously from this proposed legislation. By eliminating regulatory barriers to entry, the legislation would limit the ability some suppliers now have to exercise market power. It would provide new opportunities to achieve economies from joint production, distribution, and information management. It would provide consumers of financial services with the advantages of purchasing combinations of services from a single supplier that are now available only from separate suppliers. It would add depth and integrity to our securities markets by increasing the number and diversity of the participants in those markets.

The Depository Institution Affiliation Act would reestablish the status of the United States as the preeminent center of the financial services business by assuring open, free, and fair competition in financial services. The international trends are clear. Our laws and regulations need modernization. The longer this process is delayed, the more difficult it will be to gain the advantage in a global business that is inextricably tied to our nation's welfare.

I am William S. Haraf, Vice President for Policy Analysis with Citicorp. I am here today in my capacity as Chairman of the Issues Committee for the Financial Services Council. The Council welcomes the opportunity to testify before this Committee regarding the Bush Administration's proposal, "The Financial Institutions Reform, Recovery, and Enforcement Act of 1989" (S.413).

The Financial Services Council is a non-profit organization whose members includes companies from all major segments of the financial services industry as well as diversified firms that engage in both financial and non-financial activities. Members of the Council share a common commitment to the goal of a more competitive, efficient, and fair financial services marketplace in which the safety and soundness of depository institutions are ensured. The savings and loan institutions owned by seven members of the Financial Services Council have fully 40 percent of the tangible net worth of the entire savings and loan industry. Council Members have not contributed to the FSLIC's problems. They have been part of the solution. They would like to continue in that role.

Prompt Action Is Urgently Needed.

The problems of the savings and loan industry and its deposit insurer, the FSLIC, are immediate and severe. The Financial Services Council urges Congress in the strongest possible terms to resolve them expeditiously and to avoid needless and potentially catastrophic delays while largely extraneous matters are considered. The time to deal with this problem is now, not while frightened depositors are lined up at the doors of weak and insolvent savings and loan institutions around the country.

The Financial Services Council supports many of the concepts embodied in the Administration's proposal for dealing with this long-festering problem. In particular, the Council strongly endorses the Administration's desire to deal with insolvent institutions once and for all and to reinstitute meaningful capital standards for the industry. It is absolutely critical to the health of the financial system that insolvent institutions are dealt with promptly and that undercapitalized firms are given incentives to either bring their capital up to standard on their own, or seek a merger partner.

Deregulation is Not Responsible.

Before I comment on the Administration's bill, I would like to address a serious misconception that has apparently influenced this and other legislative proposals, and has also been reflected in statements made by Members of this Committee.

Deregulation has been made a scapegoat for the savings and loan crisis even though there is substantial consensus among experts that deregulation did not cause this problem. The savings and loan industry was in trouble long before deregulation actually occurred. Indeed, the industry's problems can to a large extent be blamed on overregulation.

The roots of this problem go back to the late 1960s. Then, savings associations were prohibited from virtually all types of lending other than long-term, fixed-rate mortgage lending within a 50-mile radius of their offices. To fund their portfolios of long-term fixed-rate mortgages, they could offer only simple passbook accounts . As a result, their financial health was extremely vulnerable to changes in interest rates and to conditions in their local markets. The inflation and higher interest rates of the late 1960s and 1970s meant that for a sustained period of time, the return on their portfolios of old mortgages stayed below the rates they had to pay on deposits in order to remain competitive and avoid deposit withdrawals.

As a result, by 1980 -- well before deregulation at the state and federal levels -- a large segment of the savings and loan industry was effectively bankrupt. Rather than forcing weak savings associations to raise new capital or seek a merger partner, regulators responded by relaxing capital standards to buy time for institutions to work their way out of problems -- first by adopting liberal accounting standards, then by lowering minimum standards, and finally by letting institutions stay in business even after they were insolvent under the most generous standards.

The policy worked to the advantage of owners and managers of seriously weakened and insolvent institutions who used federally-insured deposits to attempt to grow their way out of problems. Unlike institutions with significant capital of their own at stake, these institutions had every incentive to seek out investments offering the highest potential rate of return regardless of risk. Depositors had no incentive to avoid such institutions, since they were fully protected by FSLIC insurance.

In sum, the current FSLIC crisis is the result of many contributing factors. But the seeds were planted long ago. It was a narrowly defined charter that precluded savings associations from adapting to the higher and more volatile interest rate environment of the past twenty years. And it was the failure to promptly close, reorganize, or force recapitalization of weakened and insolvent institutions that permitted a large segment of the industry to deteriorate drastically.

The most important lesson of the FSLIC crisis is not that deregulation was a mistake, but that forbearance on capital standards and insolvency determinations is a prescription for disaster. Had capital requirements been strictly enforced, and had insolvent institutions been closed promptly, there is no way this situation could have deteriorated as badly as it did.

Forcing savings associations back into a narrow straight-jacket of mortgage lending would be a terrible mistake. It would be detrimental to safety and soundness. Indeed, the savings and loan industry and the unitary thrift holding company structure could be weakened to the point where they are no longer viable.

Financing Insolvency Resolution.

The Council is not in a position to comment on the details of the Administration's resolution funding plan. There are great uncertainties involved in estimating the ultimate cost of dealing with this problem. It will depend on the course of the economy, interest rates, and regional factors. Ultimately, the funding plan may or may not prove to be adequate. What is important, however, is that the plan involves a substantial commitment of new funds. The Administration should be commended for crafting a credible and fair approach for dealing with a very difficult problem.

Significantly, the cost to taxpayers of resolving this problem can be minimized by encouraging private sector participation in the reorganization of the savings and loan industry. The Council strongly urges that every effort be made to encourage acquisitions of weakened and insolvent, depository institutions by responsible parties. There is no doubt that restrictions on the acquisition and constraints on the operation of depository institutions have made it more difficult for the deposit insurance agencies to attract private capital to help reorganize failing institutions.

The primary concern of this Committee, however, must be the safety, soundness, and economic viability of the insured depository system over the long-term. There is a critical link between a depository institution's ability to earn a healthy rate of return on its capital, and its ability to survive and not be a burden on the deposit insurance funds. To truly ensure that taxpayers' funds will "never again" be at risk from the operation of the deposit insurance system, as Treasury Secretary Brady appropriately insisted before this Committee, depository institutions will need to attract and maintain adequate capital. In order to do so, they must be profitable, and they must have the flexibility to adapt to changing market conditions.

Several provisions in S. 413 inhibit private sector participation in the reorganization of insolvent institutions and detract from the safety and soundness of the system. I would like to consider them in turn.

(A) Qualified Thrift Lender Test. Issues of holding company regulation are of particular concern to the Financial Services Council. Title III of S. 413 would require all institutions that are not qualified thrift lenders to convert to banks and their corporate owners to become bank holding companies. This provision is unnecessarily restrictive, and may threaten safety and soundness. It would restrict the adaptability of savings associations and make them excessively vulnerable to changing conditions in mortgage markets. In addition, it eliminates a potentially significant middle-ground for thrift holding companies that may choose not to become bank holding companies, or that, because of their other activities, could not qualify as bank holding companies. By eliminating this middle ground, this provision would reduce the franchise value of insolvent or undercapitalized savings associations and therefore increase the ultimate cost to the taxpayer of resolving the savings and loan problem.

In recent years, financial innovations and increased participation by nontraditional lenders have provided ample funds for mortgage lending. The new risk-based capital guidelines that would apply to both banks and savings associations under this proposal provide further incentives to banks and thrifts to remain active in housing finance. Conditions in mortgage markets do not justify such a change in the "QTL" test.

(B) Activity Restrictions. Title II would give the FDIC authority to restrict activities of state-chartered institutions. This provision is unnecessary and may be counterproductive. It would jeopardize the dual banking system, which has produced substantial benefits over the years. Moreover, it is an inappropriate way to control risk-taking by depository institutions. The riskiness of an activity must be judged in a portfolio context. What is risk-increasing for one depository institution may be risk-reducing for another. For this reason, the Council favors strong capital regulation over blanket restrictions on activities. Provided capital standards are strictly enforced, institutions will no longer have the incentive to pursue the high-risk go-for-broke strategies that led to many savings association failures.

At a minimum, the Council would support William Seidman's proposal before this Committee on February 28 that state-chartered savings associations should be permitted to engage in activities other than those authorized for federally chartered institutions as long as those activities are housed in a separately capitalized subsidiary of the holding company with appropriate safeguards and firewalls.

(C) Liability of Commonly Controlled Financial Institutions. Title II of S.413 would give the FDIC authority to impose liability for any losses it incurs in the resolution of a failed or failing insured depository institution on other insured institutions within a holding company, regardless of any other state and federal laws.

This provision is far too broad in its scope and should be curtailed. It is completely contrary to the legal doctrine of limited liability, which holds that every corporation is a separate legal entity. This doctrine is well-established. On occasion, courts have overturned limited liability, but only rarely, and very rarely in the case of depository institutions.

The roots of this provision in S. 413 go back to the FDIC's experience with certain Texas bank holding companies whose banks were operated as integrated entities. In such circumstances, the Council believes that a healthy depository institution should be liable in the event of a failure of one of its sister institutions up to the extent of its intercompany liability to the failed institution.

Holding companies, however, should have the option to manage their insured depository institutions independently without the risk that their invested capital can be taken away by the FDIC without cause. Individuals owning more than one depository institution would not be subject to this provision (so called chain-bankers). This provision is extremely prejudicial to any organization owning more than one depository institution.

(D) Tandem and Cross-marketing Restrictions. Tandem and cross-marketing restrictions severely restrict relationships between a savings association and other operating units of its holding company. These restrictions do not enhance safety and soundness. They do, however, reduce both the economic value of a savings association acquisition and the long-term viability of the institution by restricting joint marketing and cost-saving opportunities with its affiliates.

Title VI of S.413 would allow bank holding companies to acquire any savings association, healthy or failing, without any such restrictions, but only after two years. I am sure this Committee is aware that in addition to the 350 insolvent savings associations in operation, approximately 1400 more will need to raise additional capital under this proposal by June 1991. Requiring some potential acquirers to await the actual failure of a weak institution in order to have such restrictions lifted simply lowers an institution's franchise value and raises the amount of federal assistance that would be required. Consequently, the Council shares William Seidman's view, expressed before this Committee on February 28, that all organizations, including bank holding companies, should be permitted to acquire savings associations immediately without cross-marketing and tandem restrictions and without the branching restrictions currently imposed by the Federal Reserve.

(E) The "Goodwill Hurdle" in the Calculation of Capital Adequacy. Another factor discouraging thrift acquisitions by bank holding companies has been the Federal Reserve Board's policy on capital. The Federal Reserve has not permitted bank holding company purchasers of a failed savings association to include goodwill in the calculation of capital. As a result, the additional capital required of bank holding company purchasers has made them noncompetitive in bidding for insolvent institutions and has unnecessarily raised the cost to the FSLIC of resolving failures. Although the treatment of goodwill in bank holding company acquisitions of savings associations is not addressed in this bill, it deserves the Committee's attention.

Need for Further Structural and Regulatory Reform.

Finally, the Council would like to emphasize in the strongest possible terms that there is a critical need for further structural reforms beyond those contained in S.413.

Our compartmentalized system of financial regulation is not working. The problems of the savings and loan industry and the FSLIC are merely the most obvious manifestations. They are the first victims of the clash between the revolutionary changes in financial markets and our out-dated system of regulation. Unless financial regulation is restructured to accommodate these changes, further serious problems will appear down the road.

Legitimate concerns for the safety and soundness of depository institutions justify government regulation. But restrictions on affiliations between depository institutions and other enterprises are a particularly inefficient form of regulation for ensuring safety and soundness and meeting other legitimate national goals. The evidence is clear that the main threat to a safe and sound banking system and to the deposit insurance funds is not greater integration of depository institutions with other services, but the continued operation of a large number of troubled banks and thrifts with little or no economic capital of their own at stake.

Restrictions on the affiliations of depository institutions limit competition and reduce economies of scale and scope in financial services. They limit the ability of financial services suppliers to diversify and to adapt to changing market conditions. They prevent consumers from gaining the advantage of purchasing financial services from a single supplier if they so choose. Finally, they make

financial markets in the United States less competitive internationally, and as a result, they drive financial activity overseas.

America's prosperity depends on a stable, efficient, and competitive financial system to safeguard the nation's wealth and to channel its savings to their highest valued uses. Economy-wide job creation, physical investment, and our international competitiveness are in no small measure dependent on well-functioning financial markets. Financial services are a resource for firms that are themselves competing in a global environment. The infrastructure of the 1960s was roads, telephone lines, and steel plants. Developing nations worked to build that infrastructure, and it was the chief competitive advantage of the developed nations. The infrastructure of the 1990s will be computers, telecommunications, and financial services. Keeping the edge in these critical sectors will help maintain the competitiveness of the American economy.

Recognizing the substantial public benefits associated with vibrant and competitive financial markets, some nations have actively sought to develop a regulatory climate that is hospitable to a global financial services business. The move toward European financial integration is the most recent and most dramatic effort in that direction.

As a result of these international trends, it is likely that American financial services firms will increasingly find themselves competing in international markets against large, fully integrated financial institutions. Their ability to compete effectively could well be adversely affected by the structure of our own laws and regulations, including artificial restrictions on the scope of activities of U.S. firms. At the same time, more and more of the world's financial services business could well gravitate toward the less restrictive markets overseas. Without significant changes, the financial services industry in the United States could well turn into another "rust bowl."

The Financial Services Council's legislative proposal, The Depository Institution Affiliation Act, which was introduced into the Senate in 1988 by Senators Cranston and D'Amato (S. 1905), would strengthen safeguards that protect depository institutions, while affording all companies equal opportunity to own them. The proposal closely parallels the recommendations made by the Federal Deposit Insurance Corporation in Mandate for Change (FDIC, October, 1987).

This proposal would promote competitive and efficient capital markets by giving companies a chance to meet the full range of credit and financial needs of their customers in open and fair competition with other financial services providers. At the same time, the proposal contains important new safeguards designed to protect the safety and soundness of the insured depository system, to prevent the extension of the safety net to nonbanking activities, and to protect impartiality in the granting of credit. In sum, the Depository Institution Affiliation Act is designed to address concerns not only about the stability of our system of depository institutions, but also about the efficiency, the international competitiveness, and the fairness of financial markets in the United States.

The Depository Institution Affiliation Act is not a substitute for the Administration's plan. It is complementary. The safeguards in the Council's bill go further, and are designed to address the special issues that have been raised regarding depository institutions that are owned by diversified holding companies.

The Financial Services Council's Approach to Financial Restructuring. The Depository Institution Affiliation Act would create a new legal framework for financial services. Under the act, any business could own a depository institution as a separately capitalized subsidiary of a "depository institution holding company," regardless of its other business activities. No company would be forced to give up its present holding company structure and regulation. A company that controls an insured bank or thrift would have the option to become a depository institution holding company or to operate under the present Bank Holding Company Act of 1956 or the Savings and Loan Holding Company Amendments of 1967.

The Depository Institution Affiliation Act relies on five distinct types of safeguards to protect depository institutions and the deposit insurance funds and to prevent competitive abuses:

1) Functional Regulation. Regulation of financial activities and companies would be organized along functional lines without regard to ownership, control, or affiliations.

2) Restrictions on Affiliate Transactions. The "firewalls" contained in Sections 23A and 23B of the Federal Reserve Act would be strengthened.

3) Prior Review of Acquisitions. Every person or company seeking control of a bank or thrift would be required to submit to prior review by the appropriate regulatory agency for that depository institution.

4) Divestiture Authority. Divestiture of a depository institution would be required if minimum capital standards are not maintained. Regulators would also be empowered to force divestiture of a depository institution if it, or any of its affiliates, were engaged in conduct that would endanger the safety and soundness of the depository institution.

5) Strengthened Oversight and Enforcement Authority. Regulators would be granted a number of new enforcement tools, including broad new injunctive powers. In addition, regulators would have discretion to require bank and thrift subsidiaries of a depository institution holding company to maintain additional capital of up to three percent of assets.

The divestiture provisions are an extremely powerful tool for protecting the deposit insurance funds from excessive losses and for preventing abuses of the safety net by affiliates of depository institutions. Significantly, they would be particularly useful in minimizing the disruption associated with reorganizing a large institution -- none would be "too large to fail." Combined with other provisions granting regulators greater flexibility and new enforcement tools, and imposing substantially stricter penalties for violations of the law, the act would virtually ensure that depository institution subsidiaries of depository institution holding companies would not be a burden on the deposit insurance funds.

Consumers of financial services would benefit enormously from this proposed legislation. By eliminating regulatory barriers to entry, the legislation would limit the ability some suppliers now have to exercise market power. It would provide new opportunities to achieve economies from joint production, distribution, and information management. It would provide consumers of financial services with the advantages of purchasing from a single supplier combinations of services that are now available only from separate suppliers. It would add depth and integrity to our securities markets by increasing the number and diversity of the participants in those markets. The bottom line is lower cost and better quality financial services for individuals, businesses of all sizes, and state and local governments. In the process, the productivity and competitiveness of the United States economy as a whole would be enhanced.

The Depository Institution Affiliation Act would reestablish the status of the United States as the preeminent center of the financial services business by assuring open, free, and fair competition in financial services. The international trends are clear. Our laws and regulations need modernization. The longer this process is delayed, the more difficult it will be to gain the advantage in a global business that is inextricably tied to our nation's welfare.

The CHAIRMAN. Thank you very much.

Mr. Rideout of the ABA, we'd like to hear from you now.

STATEMENT OF THOMAS P. RIDEOUT, PRESIDENT, AMERICAN BANKERS ASSOCIATION, VICE CHAIRMAN, FIRST UNION NATIONAL BANK, CHARLOTTE, NC

Mr. RIDEOUT. Thank you.

Mr. Chairman and members of the committee, my name is Thomas P. Rideout. I am vice chairman of the First Union National Bank of North Carolina, and president of the American Bankers Association. I appreciate this opportunity to present my association's views on the S&L industry and the Federal Savings and Loan Insurance Corporation.

We applaud the Bush administration's plan to resolve the S&L crisis for its fairness, its comprehensiveness, its realism, and its recognition that prompt action is needed. The differing estimates of the size of the crisis are evidence of its acceleration and the time has come to cauterize this financial wound.

The ABA's banking leadership conference last week agreed to support and work actively for the administration's plan. Specifically, we believe that the legislation should not raise bank insurance premiums above the level necessary to achieve adequate reserves for the FDIC and certainly not above the level needed to bring the fund up to the 1.25 percent of insured deposits.

The legislation should impose a strong bank-like regulatory, supervisory, capital and accounting structure on the S&L industry to help assure us that such a crisis will never happen again.

The legislation should be crafted so as not to have a negative impact on the dual banking system. The legislation should give the regulators all necessary enforcement tools but should not go overboard. It should not interfere with due process or inhibit banks' ability to attract high quality employees and directors.

The legislation should allow bank holding companies to acquire thrifts, both healthy and unhealthy, and operate them in the same manner as our competitors.

The legislation should apply equal deposit insurance funding and regulatory requirements to the credit union industry.

Congress also should consider placing the same requirements on the securities industry's insurance fund as those that apply to the FDIC and the FSLIC.

Also, reserve requirements should be imposed on money market funds. Those funds function like transaction accounts and savings accounts and should carry the same reserves as do such accounts in commercial banks.

The legislation should provide, as Senator Wirth pointed out yesterday, for orderly disposition of failed S&L's assets to avoid depressing local markets.

The legislation should not permit S&L's to use the FDIC sticker. Such abuse of the sticker could weaken public confidence in our fund.

And the legislation should mandate a study of deposit insurance reform to deal with the issues of fairness and soundness that need resolution, but these issues must not be allowed to derail or delay resolution of the S&L crisis.

Mr. Chairman, ABA supports this legislation despite its severe cuts in banks' profitability. In a good year, an average bank may earn 70 cents per $100 in assets. Thus, a 7 cent increase in our insurance premium is very costly. The bottom line and competitive impact will be deeply felt, particularly in those areas of the country with weak economies.

Nevertheless, we are willing to bite the bullet in order to end a crisis that is harming our entire financial system. Also, our willingness to accept this cost is based on ironclad assurances from the administration that our premium money will stay in the FDIC fund, that there will be no commingling of the funds, and that rebates on our premiums will begin when the FDIC's reserves reach the 1.25 percent level.

Any lasting solution to this crisis must include comprehensive action to reform the S&L industry, to correct the desupervision that allowed this mess to happen. And I would emphasize that the cause of the crisis was desupervision, not deregulation.

This reform should bring the S&L's up to bank-like capital, accounting, management and supervisory standards. Let me underline the word capital. Without the primary safety net of strong capital, all other safety nets will be highly vulnerable. And let me correct a misimpression. S&L's that don't reach the planned capital standard by 1991 will not be put out of business. All the bill says is that the S&L's that don't meet this standard won't be allowed to grow. And growth without capital is very, very dangerous, as today's crisis shows.

The treatment proposed in the bill is the same regulatory treatment that banks face today when they lack adequate capital. Given what we have all learned, to soften up on the S&L capital standards would be to repeat the same mistakes that led to the current crisis.

ABA also strongly supports the proposed restructuring of the S&L regulatory system, including putting the new Federal Home Loan Bank System under the Treasury Department. In view of the long, dismal history of the Federal Home Loan Bank Board's conflicting roles as both industry cheerleader and supervisor, we believe it is necessary for the S&L regulator to be placed under the Treasury in the same way the Comptroller of the Currency resides there.

We would add that the FDIC's independence should be protected from both political influence and OMB restrictions and oversight. The terms of the chairman and vice chairman of the FDIC should be fixed to reduce undue political pressures. OMB oversight may only constrain and delay unduly the work of the FDIC.

Allowing bank holding companies to acquire healthy thrifts is an important and much needed step to bring capital and expertise into the S&L industry and we strongly support this provision of the bill. For the same reasons, we believe bank holding companies should be allowed to acquire solvent but capital deficient S&L's immediately on the same terms as those that are applied to nonbank acquirers. This could significantly cut the number of S&L failures, producing substantial savings for the government.

We also urge the committee to permit bank holding companies to acquire healthy S&L's at an earlier date than has been proposed and on the same terms as our competitors.

As we move forward on this issue, bankers are haunted by the past. We all remember how cries for sympathy were rewarded with relaxed S&L rules and supervision a few years back and how disastrously it turned out. Any attempts to weaken the new S&L capital and regulatory standards would be deja vu of the worst kind. Enough is enough.

Our request to you is simple. This time, fix it right.

Mr. Chairman, if any bill ever deserved to be put on the fast track this bill does. Every day of delay may cost us all collectively another $40 million. Mr. Chairman, I commended the administration earlier for its effort to resolve the S&L crisis promptly. In the same vein, I commend you and this committee for your announced intention to move this legislation forward expeditiously. Ending this crisis is our Nation's top domestic priority and my association promises its full support for that effort.

Thank you very much.

[The complete prepared statement of Thomas P. Rideout follows:]

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Statement of
Thomas P. Rideout

Vice Chairman
First Union National Bank of North Carolina
Charlotte, North Carolina

President
American Bankers Association

Before the
Committee on Banking, Housing, and Urban Affairs
United States Senate

March 8, 1989

I. Introduction

Mr. Chairman and members of the Committee, my name is Thomas P. Rideout. I am Vice Chairman of the First Union National Bank of North Carolina, and President of the American Bankers Association. I appreciate the opportunity to appear before your Committee today to present the views of the American Bankers Association on the critical issues surrounding the savings and loan industry and its insuring agency, the Federal Savings and Loan Insurance Corporation.

The American Bankers Association membership ranges in size from the smallest to the very largest banks, with 85% of our members having assets of less than $100 million. The combined assets of our members comprise about 95% of the total assets of the commercial banking industry.

The American Bankers Association applauds the prompt and decisive action the new Administration is taking to address the FSLIC crisis. The Administration's plan imposes hardships on all of us, but we are in the midst of a financial emergency -- we need prompt action. The plan proposed by the Administration will get the case resolution process underway and halt the financial bleeding.

Mr. Chairman, we also applaud your prompt consideration of the President's plan. Deteriorating conditions in the savings and loan industry, aggravated by rising interest rates, impose a serious burden on our economy. Until a comprehensive plan to resolve the crisis is implemented, the burden will continue to grow each day.

A. ABA Position on Administration Plan

The Administration's plan is contained in S. 413, the Financial Institutions Recovery, Reform and Enforcement Act (FIRREA). The broad parameters of this legislation were carefully weighed by the ABA's Banking Leadership Conference last week. This group consists of the ABA's leadership and delegates, state banking association executives, and leaders of other bank trade associations -- over 400 bankers in all. After careful deliberation, we agreed to support, and work actively for, President Bush's proposed plan to solve the savings and loan crisis.

The Administration plan will have a direct long-term impact not only on the thrift industry, but on the banking industry as well. The banking industry has for years been heavily impacted by a thrift industry which has been poorly regulated and which has therefore operated in an unsafe and unsound manner. The ABA will, therefore, participate actively in the legislative process to achieve a final product that:

o does not raise bank deposit insurance premiums beyond the level necessary to achieve an adequate reserve level in the FDIC fund -- and certainly not beyond the 1.25 level contemplated in the President's proposal;

o imposes a strong bank-like regulatory structure on the thrift industry;

o does not negatively impact the dual banking system;

o gives regulators the enforcement tools necessary to ensure a safe and sound financial system, without interfering with legitimate legal rights to due process and without inhibiting the ability of banks to attract quality employees and directors;

o provides authority for bank holding companies to acquire thrifts, both healthy and unhealthy, and to operate them in the same manner as our competitors;

o applies equal requirements to the credit union industry with respect to funding of its deposit insurance fund, regulatory requirements, and taxation;

o provides for an orderly disposition of assets of failed institutions in order to avoid a negative impact on local markets;

o does not permit savings and loan to use the FDIC sticker, since such use of the sticker could weaken confidence in the bank insurance fund; and

o includes a study leading to action on deposit insurance reform -- action which will create a deposit insurance system which promotes safety and soundness and provides for equitable treatment of banks of all sizes.

The American Bankers Association believes a comprehensive approach is absolutely vital to the development of a permanent resolution to the savings and loan (S&L) crisis. The widespread insolvencies in the S&L industry are the result of a complex set of circumstances, and it is clear that the problems cannot be solved by a simple recapitalization of the FSLIC. We are pleased, therefore, that S. 413 looks beyond the immediate financial dimensions of the FSLIC's insolvency to focus on the structural deficiencies which allowed the crisis to develop and fester.

Mr. Chairman, we intend to work with this Committee and others in Congress and the Administration to achieve a fair and comprehensive solution. We will oppose amendments that would weaken those parts of the bill designed to bring S&L regulation and supervision up to bank standards. Frankly, we believe serious mistakes were made in the early years of this decade in bowing to the pressures brought by the S&L industry to weaken their capital and accounting standards.

B. Summary Comments

Bank Earnings Impact

Mr. Chairman, I emphasize that the ABA supports S. 413 even though we recognize that it will have a severe negative impact on the profitability of our industry. The proposed increases in FDIC insurance premiums will almost double the current statutory premium level and more than quadruple the level of premiums actually paid by banks just a few years ago. And while a premium increase of 7 cents per 100 dollars may not sound like much, it is large in relation to the narrow spreads in the banking industry. In a good year, an average bank may earn 70 cents per 100 dollars on assets -- in this context, a 7 cents per 100 dollars increase in expense is clearly quite significant.

The proposed increase in premiums will also add to already high regulatory costs, further undermining banks' competitive position vis-a-vis nonbank financial firms who offer bank-like services but are not subject to the same regulatory and supervisory costs. The proposed increase in deposit insurance cost also undermines U.S. banks' ability to compete with foreign institutions who do not have the same regulatory costs. In particular, foreign institutions pay significantly less for deposit insurance. See Table 1. It is no coincidence that U.S. banks have fallen from their leadership position in world financial markets. Out dated laws and heavy regulatory costs have seriously eroded the competitive position of U.S. banks.

S&L Regulatory Reform

The ABA fully supports the regulatory reforms in S. 413 to revamp the structure of the regulatory agencies, including putting the new Federal Home Loan Bank System under the Treasury Department in a manner comparable to the Comptroller of the Currency. We recognize that this proposal is controversial; however, the history of inadequate regulation by the Federal Home Loan Bank Board must be considered. Attached to our testimony is a paper which outlines this long, sad history -- the history of an industry with too close a relationship with its regulator. We believe that putting the Federal Home Loan Bank System under the Treasury is necessary to ensure that S&L regulators are held accountable for their actions and to reassure the public that this coziness will not occur again.

We also support the effort to apply bank-like regulatory requirements to the S&L industry, particularly in the area of capital standards. We are opposed to the efforts of the S&L industry to lengthen the phase-in period for complying with these capital standards. S&L officials argue that the phase-in of bank-like capital requirements is too short. Keep in mind that banks are complying with those standards now, and undercapitalized banks are being brought up to those standards with no phase-in. Moreover, as this Committee is aware, the banking industry is being required to greatly increase its capital during roughly the same period to comply with the new international Basle agreement. If we can comply, so can the thrifts.

There is, in our opinion, a misconception that hundreds of thrifts will not be able to comply with this standard, and therefore will either disappear or fail, increasing the costs of resolving the S&L crisis. This is not the case. All S. 413 says is that S&Ls that do not meet the capital standards cannot grow. Growth without adequate capital will increase the cost of the FSLIC rescue package. As is true for banks that have capital problems, the regulators would be able to work with individual S&Ls to design programs to enable them to come into compliance with the required capital ratios. Such programs could include cutting costs, curtailing dividends, selling certain assets, and, if these measures do not work, merging the institution.

Failure to impose adequate capital requirements on the S&L industry was one of the major causes of the hundred billion dollar problem we now face. It will be tragically ironic if the S&L industry once again convinces Congress to grant forbearance in the area of adequate capital.

S&L Acquisitions

The proposal to allow bank holding companies to acquire healthy thrifts is an important step to bring needed capital and expertise into the S&L industry. We strongly support this provision. Moreover, we believe bank holding companies should be allowed to acquire solvent but capital deficient savings and loan associations immediately, on the same terms as are applied to nonbank acquirers. Doing so could significantly reduce the number of additional S&L failures, thus saving the Resolution Trust Corporation and the government millions of dollars. We urge the Committee also to consider permitting bank holding companies to acquire healthy S&Ls at an earlier date.

Deposit Insurance Study

The ABA also supports the study of deposit insurance called for in the Administration's proposal. While we believe that the FDIC insurance system is strong and working well, improvements are needed. In particular, banks of all sizes must be treated equally, and an effective role for market discipline must be restored.

We agree that it would be a mistake to include comprehensive reform of the deposit insurance system in the current bill, because it would delay the resolution of the S&L crisis. However, the Administration's study will provide a forum for a Congressional review of the system in the near future.

Credit Union Insurance Fund

The ABA strongly supports the proposal to require the credit union industry to properly account for contributions to its insurance fund. We urge that Congress also take this opportunity to reform the credit union regulatory structure along the same lines as is being proposed for the savings and loan industry. In particular, we urge Congress to bring credit union capital standards up to those applicable to banks. Moreover, as is obvious in the S&L industry, a mandate to both promote and regulate can lead to serious problems. Thus, to ensure that these conflicting goals will not affect credit union regulation, Congress should consider separating the operations of the National Credit Union Share Insurance Fund from the chartering and regulatory operations of the National Credit Union Administration.

Securities Industry Insurance Fund

We also suggest that the Congress look closely at the size and structure of the securities industry's insurance fund (SIPC). In particular, we urge a review of the funding of the SIPC fund to see if changes similar to those proposed for the FDIC and FSLIC are appropriate. Consideration should also be given to imposing reserve requirements on money market funds. Changes in these areas may be desirable to enhance the safety and soundness of the securities industry.

New Enforcement Authorities

The ABA supports adequate penalties and enforcement capabilities, particularly in the case of fraud or other criminal activities. However, the ultimate goal of enforcement actions and penalties should be to strengthen the safety and soundness of the banking system within the framework of due process. If the penalties and enforcement authority of the regulators in areas outside criminal activities are too great, it will inhibit the ability of banking organizations to attract quality managers and directors. Banks already have difficulty attracting strong directors because of the personal financial risk to which such directors may be subject. We hope Congress will carefully consider the need for balance in this area.

Dual Banking System

States have historically had the power to charter depository institutions and determine the activities in which these institutions can engage. There are understandable concerns about the broad authorities some states extended to their S&Ls. Those concerns should not include state-chartered banks. There have been no abuses by state-chartered banks of state authorized activities. The FDIC has the authority to prevent or provide safeguards if it is concerned about state activities.

FDIC Sticker Use

S&Ls should not be permitted to post the FDIC insurance sign on their premises. The banking industry has worked hard to conduct its operations within the FDIC's tough capital, supervisory, and accounting standards. As a consequence, the FDIC sticker is a symbol of financial strength, and banks are viewed by the public with confidence.

The S&L industry sought and obtained weak capital, regulatory, supervisory, and accounting standards from its regulators. Given current public concern about the S&L industry, allowing S&Ls to use the FDIC sticker could weaken public confidence in the FDIC fund. Furthermore, it would be misleading to consumers to imply that thrifts are covered by the same insurance fund as banks.

FDIC Independence

The independence of the FDIC should be maintained from both political influence and from OMB restrictions and oversight. In particular, the proposed language regarding the FDIC board members may be interpreted as giving power to the President to change at any time the Chairman of the FDIC to another appointive member. The term of the Chairman and Vice Chairman of the FDIC should be fixed, thereby reducing undue political pressures. We also believe that the independence of the FDIC may be threatened by the requirement that the FDIC submit its financial plans to the Director of the Office of Management and Budget. Such oversight may serve only to constrain and delay the work of the FDIC.

We also have concerns about the proposal to limit the borrowings of the FDIC. Clearly, limits should be put in place that prohibit the deposit insurer from issuing debt if its net worth is negative. If the insuring fund has no net worth, then the marketability of these notes depends largely upon the presumption that the federal government will stand behind them. However, if the fund has positive net worth -- after reserving dollar for dollar against the debt obligation -- no such implicit guarantee is needed to assure repayment of the debt. If the net worth of the deposit insurance fund falls below zero, strict limitations on the issuance of notes should be put in place. Any such borrowings, in effect, represent a draw on the line of credit available to the deposit insurer at the Treasury and should be reflected as such.

II. ISSUES RELATED TO THE FSLIC INSOLVENCY

A. FSLIC Oversight Committee

Last year, the American Bankers Association established a FSLIC Oversight Committee to both monitor the FSLIC situation and to provide a continuing forum for discussion of the issues. This Committee has prepared two policy research papers which are attached to this testimony. The first paper, released in September 1988, outlines the issues and establishes guidelines for resolving the S&L crisis. The second paper recommends specific regulatory reforms which we believe must be a part of any comprehensive resolution. In addition to these two papers, the FSLIC Oversight Committee met February 13 - 14 to consider options for funding the FSLIC insolvency. My testimony draws heavily on the expertise of this Committee.

During their deliberations, the Committee developed a set of principles against which to evaluate proposed solutions to the S&L crisis. Underlying these principles are three key points which have become the backbone of ABA's position.

1. Insolvent thrifts must either be closed or merger quickly. Merged institutions must have adequate capital to ensure that the new entity stands a good chance of success.

2. Savings institutions must be subject to bank-like regulation and supervision.

3. The resources of the FDIC and the banking industry should not be used to bail out the savings and loan industry.

B. Savings and Loan Association Regulatory Reform

On the issue of regulatory reform, we believe the Administration's proposal is right on target. Clearly, the current FSLIC insolvency is largely the result of inadequate regulation and supervision by the Federal Home Loan Bank Board (FHLBB). In particular, our FSLIC Oversight Committee pointed to lax capital and accounting standards and inadequate closure policies as the most damaging regulatory failures.

Closure Policy

The need to implement an effective closure policy for failed thrifts has become painfully obvious. In fact, allowing insolvent institutions to continue to operate is perhaps the single biggest factor behind the explosive growth of red ink currently facing the FSLIC. We applaud the Administration's plan for recognizing the need to act quickly to close, merge or sell insolvent institutions.

Federally insured institutions operating with no capital have perverse incentives to take excessive risks. If they gamble and win on investments promising high returns, there is a chance that management will retain their jobs and that stockholders will regain some value. If they lose, the FSLIC is left with the bill. This scenario has been played out over and over again during the past several years, resulting in heavy losses at insolvent savings and loans.

Institutions operating with little or no capital cause market distortions. These institutions have pushed deposit interest rates above market rates in many areas, making it difficult for banks operating in a safe and sound manner to compete for funds. This so-called "Texas premium" phenomenon is occurring across the country and is a serious concern to bankers. Moreover, the higher leverage of under-capitalized institutions enables them to earn an adequate return on equity with lower spreads, giving them an unfair competitive advantage over soundly capitalized banks and thrifts.

Resolution Trust Corporation

We support the creation of a Resolution Trust Corporation (RTC) to assume responsibility for managing the resolution of all insolvent thrifts. We strongly support giving the RTC authority to limit asset growth and asset acquisitions, lending activities, use of brokered deposits, and interest rates payable on deposits at institutions under its jurisdiction.

We are pleased to see that the language of the proposal stresses the need for the RTC to take a long-term approach to the disposition of the assets of failed thrifts. This is a critical point in many regions of the country, and Congress should consider strengthening this provision. Our FSLIC Oversight Committee specifically expressed concern that local real estate markets should not be disrupted by a rapid dumping of such assets,

but rather that the RTC should act more like a private company to optimize the long-term value of the assets it manages.

Equally important, those thrifts which are merged or sold must be adequately capitalized so that they have a reasonable chance for success, and to assure that they will not have an unfair competitive advantage over fully capitalized institutions. There have been concerns raised that perhaps some of the thrifts which were "recapitalized" over the past few months do not in fact have enough real capital to meet these criteria. We therefore support the proposal to authorize the RTC to review and, where appropriate, restructure the FSLIC's 1988 case resolution agreements. We encourage the Administration and Congress to insist that future S&L sales result in institutions which are fully capitalized, no longer dependent on government support, and not privileged by special concessions.

Allowing bank holding companies to acquire S&Ls would provide a much needed injection of capital -- as well as management expertise -- into the savings and loan industry. We fully support the provision of S. 413 which would allow bank holding companies to acquire healthy thrifts in two years, although we would prefer to see that time period shortened or eliminated. We urge that Congress also consider allowing immediate acquisition by bank holding companies of savings and loan institutions which are still solvent, but are thinly capitalized. All acquisitions should be permitted on the same terms as would be applied to nonbank institutions which acquire an S&L. Taking steps to make acquisition of S&Ls financially attractive to banks and bank holding companies would contribute substantially to the resolution of the S&L crisis. We would like to work closely with the Committee to ensure that this option -- bank holding company acquisition of S&Ls -- is optimized. Such an approach could save the government a considerable amount of money.

Agency Restructuring

We support the recommendation to restructure the S&L regulatory system, including placing the new Federal Home Loan Bank System under the Treasury Department in a manner comparable to the Comptroller of the Currency. We believe that the S&L industry's institutional history of inadequate regulation and supervision clearly justifies that such action be taken.

Some in the S&L industry have proposed that instead of placing the FHLBB under Treasury, it should be placed in the Department of Housing and Urban Development (HUD). This idea should be rejected. After comprehensive study, the ABA's FSLIC Oversight Committee concluded that poor supervision and regulation of the S&L industry can be attributed in part to the the statutory mandate of the FHLBB to promote home financing, while also acting as the regulator of the S&L industry. Placing the FHLBB in HUD would not correct this situation, it would aggravate it.

Related to the issue of restructuring the FHLBB is the need for parallel treatment of the credit union industry. There are certain similarities between the current regulatory structure of the credit union industry and the savings and loan industry. For example, the National Credit Union Administration (NCUA) is the federal chartering agency as well as the supervisory and regulatory agency. NCUA also has legal responsibility over the credit union insurance fund and the Central Liquidity Facility. Furthermore, as is true in the savings and loan industry, the Federal Credit Union Act also contains language which directs the NCUA to be, in effect, a "cheerleader" for the industry. Congress should consider striking that portion of the credit union act, and separating the chartering, supervision and regulation function from the insurance function as is currently being proposed for the S&L industry.

Regulatory, Supervisory, and Accounting Reform

We strongly support the proposal to apply bank-like capital standards to the S&L industry, and we will strenuously oppose efforts to lengthen the phase-in period or otherwise dilute their effectiveness. We are convinced that the accounting and capital concessions granted by S&L industry regulators during the 1980s served only to disguise their insolvency and allow the problems to worsen.

Some S&Ls have argued that the time frame for meeting the proposed capital standard is too short and unusually harsh. However, the failure of S&L regulation and supervision is nowhere more evident than in the deterioration of net worth positions of FSLIC-insured institutions during the 1970s and early 1980s. During this time, net worth requirements in the S&L industry were effectively dismantled. Any delay is establishing firm capital standards would repeat the regulatory mistakes which led to the current crisis.

We recognize that meeting the proposed capital standards will be difficult for some savings and loan associations. However, under the Federal Reserve Board's risk-based capital standards, residential mortgage loans carry a "risk-weight" of one-half that of most other forms of lending. This will considerably reduce the capital requirement for S&Ls whose primary assets are residential mortgages. In addition, the proposed bill allows a ten year amortization of goodwill which will also ease the transition to a higher capital standard.

Contrary to the perception of many, those savings and loan associations that cannot meet the June 1991 deadline will not simply be closed. All the bill requires is that those institutions which do not meet the capital requirements after 1991 not be allowed to grow. For example, if regulators find an S&L's capital to be unacceptably low, they may require it to reduce dividends, sell assets, limit the growth of deposits, restrict loans to new customers and loans to officers and directors of the S&L, or merge with another organization which can supply additional capital. These are the same measures that are applied today to a bank that does not meet its capital requirements.

There are other S&L regulations in addition to stronger capital standards that need to be brought up to comparable bank standards. These include incorporation standards, liquidity requirements, and limits on loans to one borrower. A full discussion of need for these standards is contained in the ABA FSLIC Oversight Committee's paper, "Savings and Loan Association Regulatory Reform: Action Recommendations and Historical Perspective" included in this testimony.

Perhaps the most striking example of regulatory attempts to mask the developing problems in the savings and loan industry is the use of permissive regulatory accounting principles (RAP). Using RAP delayed recognition of the growing number of insolvencies that were painfully obvious under generally accepted accounting principles (GAAP) or under a tangible capital basis. Furthermore, the FHLBB not only delayed moving to a GAAP standard, as mandated by Congress in the Competitive Equality Banking Act of 1987, but three RAP exceptions were retained until January 1994. We urge Congress to eliminate any remaining elements of regulatory accounting principles to prevent the continued overstatement of S&L net worth positions.

C. FDIC Resources and the S&L Bailout

It appears that the Administration's plan does not involve any direct use of FDIC funds or premium income collected from insured banks for the S&L bailout, and the proposal for an administrative merger of the FDIC and FSLIC apparently intends that the funds themselves will be kept separate. We strongly support each of these positions. The banking industry is not responsible for the condition of the S&L industry or FSLIC. In fact, the less restrictive regulation which is in large part responsible for the current FSLIC insolvency has given the S&L industry significant competitive advantages over banks for years. It would clearly be unjust to use bank resources to bail out our competitors.

While we are pleased that there will apparently be no direct use of bank funds, we are concerned about the potential for indirect use of FDIC resources as a result of the administrative merger of the agencies. Specifically, our FSLIC Oversight Committee was concerned about the allocation of both administrative expenses and supervisory and regulatory resources. We believe that the administrative merger should not directly or indirectly result in bank deposit insurance premiums being used to fund administrative or other costs associated with the FSLIC's case resolution process or the supervision and regulation of the S&L industry. We recommend that the final legislation carefully spell out how personnel and overhead costs are to be allocated.

III. OTHER ISSUES

A. Deposit Insurance

The Administration's proposal rightfully considers the strength of the entire federal deposit insurance system in its recommendations. Besides measures to recapitalize the FSLIC fund, it considers the adequacy of the FDIC and National Credit Union Administration funds.

FDIC Insurance Assessment

The ABA strongly supports the continuation of a healthy FDIC fund. We have agreed to support the President's proposal -- including its provisions to establish a target of 1.25 percent of insured deposits and to increase our premiums to reach that target. However, we think it is important that Congress understand that this increase imposes a hardship on our industry.

In addition, the language in the bill as submitted is deficient in our opinion and we are working with the FDIC on suggestions to have it conform more closely to the original summary of the President's proposal.

To strengthen the FDIC fund, the Administration proposes that insurance premiums of FDIC-insured institutions be raised from their current level of 8.3 cents per 100 dollars to 12 cents per 100 dollars by 1990 and 15 cents per 100 dollars by 1991. This amounts to a near quadrupling of bank insurance premiums from that actually paid (including premium rebates) by banks at the beginning of the 1980s.

In considering the merits of this proposal, it is important to keep in mind that the size of the insurance reserve is only one of many elements of a strong and effective deposit insurance system. Supervision, regulation, examination, and use of enforcement powers are integral components of the deposit insurance system. Capital standards are clearly very important because they act as a buffer to absorb losses before insurance funds are ever called upon. Another vitally important element in protecting the strength of the insurance fund is a policy that closes institutions quickly once they become insolvent.

Effective use of regulation and supervision reduces the risk of institution failure, and therefore reduces the requisite size of the insurance fund. In stark contrast to recent experience in the S&L industry, the past history of bank regulation and supervision demonstrates the effectiveness of these policies in ensuring a strong FDIC. Bank regulation and supervision has been thorough, swift and professional. When threats to safety and soundness are detected, corrective actions are promptly initiated.

Of course, no system of regulation can prevent losses from occurring. And while the magnitude of loss experience of the FDIC last year is of some concern, it must be kept in perspective. First, last year was the first time in the history of the FDIC that operating losses caused the insurance fund to decline. Second, the principle of an insurance reserve is to have a pool of funds available to absorb losses in bad years and recover those losses in good years. The insurance pool's effectiveness was clearly demonstrated as the FDIC fund quite easily handled a significant volume of bank failures over the last few years. Third, Chairman Seidman and many other analysts have suggested that the FDIC's worst problems are over. This suggests that even with the current premium schedule the fund would be rebuilt over time. The Administration's proposal would simply accelerate this rebuilding.

Although acceleration may be designed to strengthen the fund, it could have the opposite effect if carried too far -- it may actually place the fund at greater risk. The fiercely competitive nature of the financial industry suggests that banks will not pass the increased cost of deposit insurance premiums through to their customers. Thus, the full impact of the proposed premium increase will fall on banks and will clearly take a toll on bank earnings. While seven cents per $100 dollars does not sound like much of an increase, the fact is that in a good year banks on average earn only about 70 cents per $100 dollars. An increase in premiums equal to roughly ten percent of the average return on assets will surely affect banks' bottom line. While this may not jeopardize the stability of the majority of institutions, it may be enough to push marginally profitable banks into the red. This is particularly likely in those regions of the country experiencing severe economic problems. Bankers in Oklahoma, for example, report that the proposed premium increases are large enough to virtually wipe out bank income for the entire state.

Even for more profitable banks, the proposed increase in premiums will add to the already high regulatory costs and will continue to undermine the ability of banking organizations to compete with nonbank financial firms who offer bank-like services but are not subject to the same capital standards, reserve requirements, and close supervision and regulation.

The proposed increase in premium costs also undermines U.S. banks' ability to compete with foreign banks who do not have the same regulatory costs. In particular, foreign banking institutions pay significantly less for deposit insurance. For example, Japanese banks pay only 1.2 cents per 100 dollars compared to U.S. banks' payment of 8.3 cent per 100 dollars. German banks pay, on a voluntary basis, nearly two-thirds less than that of U.S. banks, and Canadian banks pay about 90 percent of premium rate paid by U.S. banks. See Table 1. While differences in explicit coverage exist among countries, implicit guarantees to support the banking industry are generally considered to be the same among the large industrial countries.

It is no coincidence that U.S. banks have fallen from their leadership position in world financial markets. Outdated laws and heavy regulatory costs have made it increasingly difficult for domestic banking organizations to compete effectively. The proposed increase in premiums only accentuates this competitive disadvantage.

The proposed increase in premium costs comes at the same time that commercial banks are being asked to raise additional capital. Under the new risk-based capital guidelines adopted by the Federal Reserve, commercial banks will be required to have capital equal to 7.25 percent of risk-assets by 1990 and 8.00 percent of risk-assets by 1992. These are increases from the current six percent capital to assets standard.

Raising both insurance premiums and capital requirements for banks clearly runs counter to general insurance practices. Capital is the first line of defense, absorbing any losses before insurance funds are called upon. It acts, therefore, in the same manner as a "deductible" on any insurance policy. Standard practice dictates that the higher the deductible level the lower the premium. This simply reflects the fact that the risk to the insurance fund declines the more "up front" money there is to absorb losses.

We also want to point out that the proposed increase in insurance premiums will have a negative impact on banks' ability to raise capital. As bank profitability declines, so does bank return on equity. This makes banks a much less attractive investment compared with other alternatives.

Banks are already hard pressed to attract capital into the industry. Due to growing competition both domestically and internationally, the banking industry's return on equity has declined in seven of the last nine years. Moreover, banks' return on equity is much lower than that of other industries. For example, from 1983 through 1987, bank return on equity averaged just 8.9 percent, compared to 11.5 percent for nonbank financial firms and 12.1 percent for industrial firms. As Table 2 shows, if the insurance premium had been at 15 basis points throughout this period, bank return on equity would have been only 8.4 percent.

We are also troubled by the provision in S. 413 which gives the FDIC "authority and discretion to fix the annual assessment rate for insured institutions above the levels" proposed by the bill. Such power should only be granted if extraordinary circumstances exist that markedly raise the risk of serious future losses to the FDIC.

The ABA firmly believes that the bill should not raise bank deposit insurance premiums beyond the level necessary to achieve an adequate reserve level in the FDIC fund -- and certainly not beyond the 1.25 percent contemplated in the President's proposal. Having said this, please note that America's bankers are supporting this proposal even though it will impose a significant cost burden.

Treasury Deposit Insurance Study

We strongly support the Administration's proposal to study additional aspects of deposit insurance. The six topics listed in the proposal are worthy of extensive and thoughtful study. In addition, the issue of brokered deposits in our judgment should also be included for study. We hope that the end result will be the enactment of reform legislation ensuring a deposit insurance system that supports safety and soundness and is equitable to banks of all sizes.

One further comment is necessary on deposit insurance. We wish to emphasize that the $100,000 level of coverage should not be lowered, and we are pleased that many members of Congress have reacted negatively to suggestions that this might be appropriate policy.

Securities Investor Protection Corporation

The protection afforded under the federally sponsored Securities Investor Protection Corporation (SIPC) should also be examined and consideration given to placing this fund on a comparable level to deposit insuring funds. SIPC and the FDIC were established with the same statutory objective to maintain public confidence in the financial system. Furthermore, SIPC's funding, government credit backing, and governing structure are almost identical to the FDIC's. SIPC also has a line of credit with the Treasury of $1 billion if its reserve fund becomes depleted. Congress should determine the extent of SIPC's exposure and the sufficiency of its reserve fund -- figures that are currently not disclosed by the corporation.

The federal "safety net" clearly extends to large securities firms as well as large banks. For example, during the silver crisis of 1980, the Drysdale failure of 1982, and the stock market crash of 1987, the Federal Reserve showed that it will provide liquidity and take other supportive

actions to prevent instability irrespective of whether the problems started with imminent failure of a bank or a securities firm.

B. New Penalty And Enforcement Authorities

ABA supports granting to regulatory agencies the tools they need to protect the integrity of depository institutions. Individuals who steal from institutions or divert bank funds for their own purposes must be driven out, punished, and the funds taken must be returned to the institutions.

At the same time, in our mutual desire to root out wrongdoers we must take care to preserve individual rights to due process of law. The sheer magnitude of the increase in the level of civil penalties -- up to $1 million per day -- dictates that extreme care be taken in the standards applicable and powers of regulators to assess these penalties. A number of provisions in this bill go significantly farther than the so-called "regulators bill" which was considered and approved by this Committee last year.

Regulatory overkill must be avoided. We are very concerned that some portions of the enforcement provisions grant overly broad authority creating the potential for abuse by an overzealous bank examiner. Competent law-abiding individuals should not be deterred from working for banks. More than ever our financial system needs capable management. ABA will be submitting suggested changes to preserve the rights of individuals to due process of law, while at the same time providing the regulators the supervisory powers they need. With the changes suggested, we believe the bill will strike an appropriate balance.

C. Dual Banking System and States Rights

For decades, the dual system of state and federal chartering of banks has served this country well. It would be a significant policy error to halt or jeopardize innovation at the state level which in the past has led to the adoption of many beneficial policies.

The dual banking system has made many important contributions to our banking system. Duality allows each state to function as a laboratory where experiments can be performed on a small scale at minimal risk. This type of innovation at the state level has led over time to the adoption of beneficial policies in other states and at the national level. Such common banking services as checking accounts, bank trust activities, and real estate lending are examples of activities which began at the state level. One more recent example is the development of NOW accounts which allows consumers to earn interest on their transactions deposits. Another example is the decision by many states to open their borders to banking organizations from other states. The growing number of states which have chosen either to join with neighboring states in regional banking compacts or to allow interstate banking on a non-reciprocal basis demonstrates that many states believe their citizens will benefit from interstate banking.

Several states are currently leading the way in enhancing competition in the provision of financial services by allowing their state chartered institutions to participate in insurance underwriting and brokerage. The consumer benefits of such bank insurance activities have been well documented. In fact, a Consumer Federation of America study found substantial evidence that consumers would benefit from bank insurance entry, and concluded that there is no reason to prohibit states from selling insurance. The voters of California recently voted to permit state chartered banks to sell insurance.

This position was endorsed by a coalition of 24 consumer groups which expressed their opposition to a legislative proposal that would have restricted the rights of states to authorize insurance activities for their state chartered banks.

States have historically had the power to charter depository institutions and determine the activities in which these institutions can engage. While both the Federal Reserve Board and the Federal Deposit Insurance Corporation clearly have an important role to play in the regulatory process, until now the federal government has not directly challenged the right of each state to determine the products and services that can be offered by its independent state chartered banks.

The existing bank regulatory structure already offers a sufficient range of tools with which the FDIC and other regulatory agencies can control the risk-taking activities of insured banks. The first line of defense is the examination process itself, during which trained examiners assess the current financial condition of the institution, as well as the expertise of the bank's management and the adequacy of the systems in place within the bank to ensure that its day to day operations are conducted in a safe and sound manner.

Moreover, state and federal regulators currently have a broad range of enforcement powers to correct any deficiencies they may discover during the examination. These powers range from supervisory agreements in which regulators and the financial institution agree upon an appropriate course of action, to cease and desist orders in which regulators can stop an institution from engaging in certain actions, to the actual removal of officers and directors.

Clearly the best protection for the deposit insurance fund is an adequate closure policy. As we have learned from the current FSLIC insolvency, failure to close insolvent institutions allows the problem to grow exponentially. One reason the FDIC has been able to handle the difficulties experienced by the banking industry over the past few years without catastrophic losses is that the bank regulators have closely monitored problem banks, and have acted quickly to close or merge insolvent banks.

The FDIC already has the regulatory authority to prevent an insured bank from offering a service and risking insured deposits if it believes the bank's activities are unsafe. No further authority is needed. The current structure of examination, regulation and supervision provides bank regulators with adequate means to ensure that insured institutions operate in a safe and sound manner.

D. Housing Finance Issues

The S&L industry has historically been an important source of home financing. During the public debate on S. 413, some have raised concerns that the proposed regulatory reforms will somehow reduce the availability of home mortgages, and that home buyers will have to pay higher rates to get financing. We believe these fears are unfounded.

There is nothing in S. 413 that reduces the ability of savings and loans to provide mortgage financing. In fact, the regulatory reforms proposed by the bill will strengthen the savings and loan industry, putting it in a better position to participate in mortgage lending both directly through portfolio holdings and indirectly through the secondary market.

The Growing Importance of Securitization

In designing the proper structure of the S&L industry, however, it is important to understand the tremendous changes that are taking place in housing finance. Significant innovations have evolved in recent years which have fundamentally transformed the mortgage market. At the heart of this transformation is securitization -- the pooling of similar types of small loans to be used as collateral for issuance of a security. Residential mortgages have proven to be well suited to this process, and have led the way in asset securitization.

This increasing use of securities markets to fund residential mortgages will reduce the reliance on both banks and thrifts as primary mortgage lenders. Moreover, funding mortgages in the securities markets through the securitization process reduces the cost of borrowing for two reasons. First, the intermediation cost of raising funds through securities markets is lower than the cost of traditional bank and S&L intermediation. Second, debt securities appeal to a broader pool of potential funds suppliers than do traditional loan instruments. This broader appeal means that life insurance companies, pension funds, and even foreign investors are holding a much larger share of mortgage loans outstanding than was the case a decade ago. And the larger the pool of potential investors, the lower the cost to the borrower.

The importance of securitization in facilitating home mortgage lending is clearly reflected in its recent growth shown on Chart 1. Mortgage-backed securities as a percent of total mortgages outstanding grew from about 5 percent in 1975 to over 33 percent by 1988. An estimated 70 - 80 percent of the $444.5 billion of residential mortgage loans originated in the 12 month period September 1987 - September 1988 were securitized.

Functional Tax Incentives for Mortgage Lending

Congress could take a positive step toward encouraging lenders to increase their participation in funding residential mortgages by restructuring the tax incentives for housing finance so that all lenders can qualify, and by making it available on an incremental basis. Such a revision would be a clear boost to housing in this country while at the same time making the tax code more equitable by providing functional taxation of all mortgage lenders.

Specifically, we recommend that a tax incentives be available to all lenders on a proportional basis. For example, an institution with 60 percent of its assets in mortgages would get twice as much credit as an institution with 30 percent of its assets in mortgages; each would get the same additional credit for equal increases in their mortgage assets. Granting a proportional tax incentive for mortgage lending on a functional basis would encourage increased participation by all lenders.

Equal Access to Federal Home Loan Bank Advances

Another means by which Congress can encourage participation in residential financing is to allow all home mortgage lenders to have access to the advances mechanism of the Federal Home Loan Banks. Advances have been an important source of mortgage funds for savings and loans, accounting for approximately nine percent of their liabilities in recent years. If Congress believes that this is a desirable way to help provide stability in residential mortgage markets, consideration should be given to making advances available to all long-term mortgage lenders on an equal basis. The principle here is one of linking the incentive to the mortgage instrument and not to the institution charter.

B. Credit Union Considerations

In addition to making comparable regulatory and supervisory standards for S&Ls and banks, we recommend that S. 413 be extended to include comparable standards for credit unions to insure the safety and soundness of that industry. We recognize that this is not a credit union bill, but Congress has a real opportunity to bring about needed uniformity in the critical safety and soundness regulations governing all federally insured depositories.

As noted earlier, the ABA is pleased that S. 413 would require credit unions to expense over eight years the one percent of insured deposits presently held at the National Credit Union Share Insurance Fund (NCUSIF). We strongly support this proposal. There is no reason that this one percent should be counted as capital for both the industry and its insurance fund -- and there is a critically important reason why it should not be counted.

The one percent contributed reserve is not a financially sound reserve. It will need to be drawn upon at a time of crisis in the credit union industry. When it is drawn upon, credit unions will have to reduce the one percent investment on their books which in turn will reduce their capital positions significantly and at precisely the time when they are least able to afford to do so. This is a safety and soundness issue of significant dimensions and should not be ignored.

Recognizing the declining capacity of the NCUSIF, 1984 legislation required insured credit unions to contribute one percent of their deposits to capitalize the insurance fund. Each year, credit unions must also contribute one percent of their deposit growth to the fund. Although these insurance contributions represent capital of the NCUSIF, credit unions are still permitted to record them as assets on their books. Moreover, a credit union's contributions are returned if insurance coverage is terminated. As

Table 3 shows, these contributions amounted to $1.3 billion of the $1.6 billion in the NCUSIF at the end of 1987.

In contrast, contributions to the corresponding deposit insurance funds of banks and S&Ls are non-refundable expenses. These expenses decrease an institution's net income, and thus decrease retained earnings available to augment capital. If credit union insurance contributions had been expensed like bank deposit insurance premiums instead of being booked as an asset, the industry's reserve to assets ratio would have been an estimated 5.7 percent at the end of 1987 rather than 6.5 percent. Table 4 shows how the capital of the credit union industry would look under this more appropriate accounting method.

The growing risk exposure and the deteriorating capital position of credit unions suggests that capital standards for this industry should be brought up to bank standards. As with S&Ls, credit unions' assets have been growing rapidly in the 1980s while asset quality has fallen. For example, since 1982 the average annual growth rate of credit union assets exceeded 17 percent, and the average rate for S&Ls exceeded 12 percent -- while the average rate for banks was less than 7 percent. The growing credit quality problems are obvious from the increasing loan loss rate -- loan losses at credit unions rose 64 percent from 1984 to 1987.

In 1987, the National Credit Union Administration (NCUA) proposed strengthening credit union capital standards in light of the increasing risk exposure. A task force -- with representatives from the NCUA, the National Association of State Credit Union Supervisors, and the largest credit union trade groups -- was organized last March to study the proposal. The task force estimated that about thirty percent of all credit unions have a capital to asset ratio of less than five percent, and concluded that higher capital standards are needed for the industry. Industry leaders indicated that they intend to ask Congress to set minimum capital requirements for their institutions in order to prepare for future uncertainties.

Given the intent of the Administration's proposal to enhance the safety of all financial institutions, we suggest that S. 413 be amended to include capital requirements for credit unions which are consistent with those for banks and S&Ls.

VI. APPENDIX A: TABLES AND CHARTS

TABLE 1

COMPARISON OF U.S. BANK DEPOSIT INSURANCE PREMIUMS TO THOSE OF CANADA, WEST GERMANY, JAPAN, AND THE UNITED KINGDOM

Because the assessment base differs among countries, comparisons should only be made between each country's premium and the U.S. equivalent premium using the same assessment base

	Canada	Germany[1]	Japan
Foreign Premium (cents/$100)	10.0[2]	3.0[3]	1.2
U.S. Equivalent[4] (cents/$100)			
Current 1989 Rate:	11.0	8.5	8.3
Proposed 1990 Rate:	15.9	12.3	12.0
Proposed 1991 Rate:	19.9	15.3	15.0
Premium Assessment Base	Insured Deposits	Total Deposits Less Inter-Bank Deposits	Total Deposits

United Kingdom

U.K. Initial Assessment Range	2,500 - 300,000 Pounds
U.S. Equivalent[5,6]	4,250 - 510,000 Dollars

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[1] Voluntary Program

[2] Premiums can be raised up to 16.7 cents per 100 dollars.

[3] An additional 3 cents/100 dollars can be assessed if needed.

[4] Conversion based on year-end 1987 data.

[5] Exchange rate of $1.7/Pound

[6] This represents the initial assessment range. Additions to this initial commitment can be made as bank size or condition change. Maximum total contribution cannot exceed .3 percent of deposit base. To compare what the initial assessment might be if applied to a U.S. bank, the following table was constructed. It shows the size of U.S. bank that would generate the highest and lowest initial premiums under the U.K. system. For example, at the current assessment of 8.3 cents/100 dollars, a bank of $614 million would pay a premium of $510,000, the maximum range. Internationally competitive U.S. banks generally exceed $5 billion in deposits, paying yearly insurance premiums in excess of $4 million. The average domestic deposits in U.S. banks is $154.6, which gives rise to a yearly premium of $128,000.

U.S. Bank Size Necessary to Generate Assessment Range ($ million)

	Premiums	Minimum	Maximum
Current	8.3	5.1	614
Proposed 1990	12.0	3.5	425
Proposed 1991	15.0	2.8	340

TABLE 2

COMPARISON OF INDUSTRY PROFITABILITY: IMPACT OF PROPOSED INCREASE IN DEPOSIT INSURANCE PREMIUMS ON COMMERCIAL BANK RETURN ON EQUITY

The actual average 1983 through 1987 return on equity of the commercial banking industry was 8.9 percent, well below the "Industrial 500" median and below the "Service 500" median. Assuming the Bush Administration's FDIC deposit insurance premium increase had been in effect at fifteen cents per $100 dollars of domestic deposits throughout this period, the banking industry's return on equity would have been only 8.4 percent.

Industry Groups	Average 1983-87
Pharmaceuticals	19.5
Publishing, Printing	18.5
Tobacco	17.7
Beverages	16.6
Food	15.5
Soaps, Cosmetics	15.4
Retailing	14.1
Transportation Equipment	13.8
Apparel	13.0
Aerospace	12.8
Science and Photographic Equipment	12.7
Metal Products	12.3
Motor Vehicles and Parts	12.1
Electronics	12.1
Computers	12.0
Utilities	11.8
Non-Bank Financial	11.5
Chemicals	11.3
Rubber Products	11.1
Forest Products	10.9
Furniture	10.5
Building Materials	10.5
Service Companies	10.0
Mining, Crude-Oil Products	9.9
Petroleum Refining	9.0
* Commercial Banking (w/out prem. incr.)	8.9
Transportation Companies	8.9
Textiles	8.7
* Commercial Banking (with prem. incr.)	8.4
Industrial and Farm Equipment	7.0
Metals	5.7
Industrial 500 Median	12.1
Service 500 Median	10.2

Source: Fortune Magazine, 500 Industrial and Service 500 lists, 1983 through 1987.

TABLE 3

NATIONAL CREDIT UNION SHARE INSURANCE FUND AS A PERCENT OF NCUSIF-INSURED SHARES 1973 - 1988

Year	Insurance Fund Reserves as a percent of Shares at NCUSIF-Insured Credit Unions	Credit Union Insurance Fund Reserves
	(Percent)	($ thousands)
1973	0.16	26,150
1974	0.16	31,968
1975	0.19	47,196
1976	0.22	67,596
1977	0.24	89,870
1978	0.27	118,921
1979	0.32	152,610
1980	0.30	165,620
1981	0.30	174,716
1982	0.26	177,921
1983	0.29	235,209
1984,	0.31	285,540
1985[1]	1.28	1,119,356
1986	1.24	1,411,391
1987	1.23	1,602,251
1988	1.24	1,900,000

---

[1] In 1984, legislation was passed providing for the capitalization of the fund through the contribution by each insured credit union of an amount equal to 1% of the credit union's insured shares (deposits). Payments to the fund became effective on January 21, 1985 and were adjusted annually thereafter. Each year credit unions' must contribute 1% of deposit growth to replenish the fund. Once the fund reaches 1.30 percent of deposits, the excess is returned to each insured credit union.

Contributions made to the fund are carried as an investment in the credit union's books. These deposits do not pay interest, but in the event that the fund were to be merged into the FDIC and FSLIC insurance funds, they must be returned to the individual credit unions.

Source: National Credit Union Administration.

TABLE 4

CAPITAL TO ASSET RATIOS[1] OF NCUSIF-INSURED CREDIT UNIONS

Year	Capital to asset ratio	Capital to asset ratio less CUs deposits at the NCUSIF[2]
1981	6.4	-
1982	6.4	-
1983	6.0	-
1984	6.3	-
1985	6.3	5.9
1986	6.2	5.5
1987	6.5	5.8,
1988	6.5	5.7[3]

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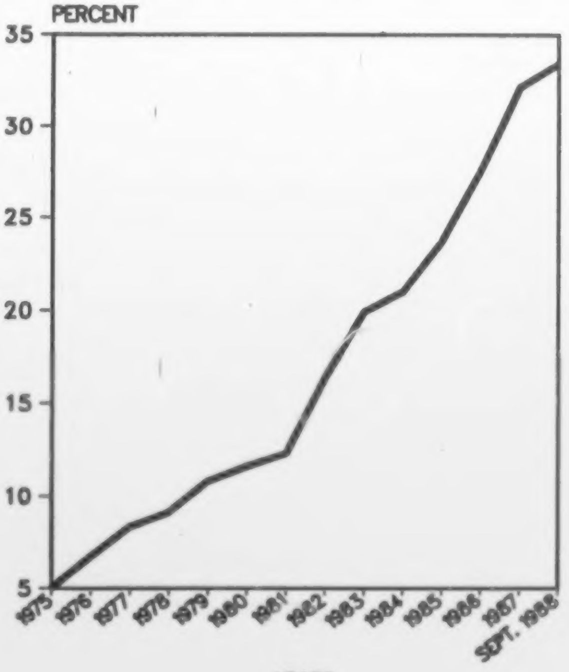
[1] Reserves plus undivided profits divided by total assets.

[2] The National Credit Union Share Insurance Fund (NCUSIF) was capitalized in 1985 by requiring insured credit unions to deposit an amount equal to one percent of their deposits (shares) at the NCUSIF.

[3] Estimate.

Sources: NCUA Annual Reports 1980 - 1987, NCUA Yearly Statistics for Federally Insured Credit Unions 1986 - June 1988.

CHART 1
MORTGAGE-BACKED SECURITIES OUTSTANDING AS A PERCENT OF TOTAL RESIDENTIAL MORTGAGES OUTSTANDING



SOURCE: FEDERAL RESERVE BOARD

V. APPENDIX B: REPORTS OF THE ABA FSLIC OVERSIGHT COMMITTEE

THE FSLIC CRISIS: PRINCIPLES AND ISSUES
A CALL TO ACTION

American Bankers Association
September 20, 1988
Washington, D. C.

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THE FSLIC CRISIS: PRINCIPLES AND ISSUES

A CALL TO ACTION

I. Action Recommendations

The thrift industry's problem and the growing insolvency of the Federal Savings and Loan Insurance Corporation (FSLIC) pose a threat to the U.S. financial system.

Actions to resolve this crisis should be initiated immediately.

The American Bankers Association (ABA) has for several years closely monitored the growing thrift industry problem. Concerned that the FSLIC recapitalization plan enacted by Congress in August 1987 would be inadequate, the ABA established a permanent FSLIC Oversight Committee in early 1988. This document is a report of the FSLIC Oversight Committee and is based on currently available information concerning the FSLIC and thrift industry condition. This report is expected to be followed by other ABA policy papers focusing more specifically on key regulatory, funding, and deposit insurance reform issues, and refining the policy recommendations presented in this report.

Drawing on the principles and findings of the FSLIC Oversight Committee, the American Bankers Association urges implementation of the following action recommendations.

A. Immediate Actions

1. **Halt the growth of insolvent and nearly-insolvent FSLIC-insured thrift institutions.** Using its general safety and soundness authorities, the Federal Home Loan Bank Board (FHLBB) should immediately halt the growth of the 900 or more insolvent and nearly-insolvent FSLIC-insured institutions.

2. **Increase the pace of liquidating insolvent institutions.** The FSLIC must aggressively liquidate (by deposit payoff or assisted merger) insolvent institutions to reverse the growth of the FSLIC's insolvency.

    a. **Eliminate constraints on personnel resources and administrative procedures needed to liquidate expeditiously insolvent thrifts.** The FHLBB should continue to augment its liquidation personnel resources and improve administrative procedures.

    b. **Eliminate any financial constraints on the pace of liquidating bankrupt thrift institutions.** The FHLBB should be prepared to exercise full and prompt use of the present FSLIC recapitalization plan resources. Federal Home Loan Banks should use their capital to lend to the FSLIC the funds necessary to liquidate insolvent thrifts.

3. **Extend current tax law which facilitates the FSLIC's ability to arrange for assisted acquisition of troubled thrift institutions.** Continuation of these provisions would allow the FSLIC to resolve more cases, at a faster pace, than if the current law were to expire as scheduled at the end of 1988.

B. Near-term Actions -- 1988

1. **Document the regulatory, supervisory, and accounting deficiencies in the thrift industry to effect correction as soon as possible.** The Federal Financial Institutions Examination Council should research and document deficiencies in thrift regulatory, supervisory, and accounting practices as a basis for formulating a program for correction. Its findings should be reported to the public and Congress.

2. **Develop a framework for increasing the pace of bankrupt thrift liquidations.** Congress and appropriate executive branch entities should thoroughly examine current administrative procedures and methods for liquidating failed thrifts, and improve them immediately to the extent possible. If necessary, a new governmental framework, possibly including a limited-life corporation, should be developed for taking over insolvent thrifts, selling them or paying off their insured depositors, and selling their assets over time.

3. **Evaluate the effect of the 1987 FSLIC recapitalization plan on thrift institution insolvencies.** Special assessments comprise a major part of this plan, and while this is an appropriate way to raise thrift industry funds to help resolve the problem, the assessments should not be so burdensome that they result in additional thrift insolvencies. Congress and appropriate executive branch entities should review the extent to which the special assessments are counterproductive and review all methods of utilizing thrift industry resources without creating additional insolvencies.

4. **Prepare additional means for funding the liquidation of insolvent FSLIC-insured thrift institutions.** The FSLIC insolvency is much larger than can be handled by the 1987 recapitalization plan. Congress and appropriate executive branch entities should catalog and assess the costs and benefits of all available short-term and long-term funding options. A plan should be formulated to provide whatever additional funds are needed to close promptly all remaining insolvent FSLIC-insured thrifts. Extreme care must be taken to find a solution for funding that does not weaken other depository institutions or create a crisis in confidence in the minds of insured depositors in these institutions.

C. Longer-term Actions -- 1989

1. Enact legislation bringing thrift industry regulatory, supervisory, and accounting standards up to banking industry levels.
2. Enact legislation directing and enabling a substantial increase in the pace of insolvent thrift liquidations and providing a sound means for funding the liquidation process. The funding process should not include use of FDIC resources. Use of FDIC resources to address the FSLIC's problems would be unrealistic and financially unwise.
3. Permit bank holding companies to acquire and operate thrift institutions as a means for providing additional capital to the thrift industry.
4. Develop a framework for reforming deposit insurance and insured institution supervision involving increased reliance on market discipline to assure that a crisis like that besetting the thrift industry does not reoccur.
5. Reconsider whether a specialized housing credit system consisting of specialized lenders and the Federal Home Loan Banks is needed.

II. Findings of the ABA's FSLIC Oversight Committee

A. Principles and Issues

The American Bankers Association (ABA) has carefully monitored the condition of the Federal Savings and Loan Insurance Corporation (FSLIC) and the thrift industry for several years. A report entitled *Federal Savings and Loan Insurance Corporation: Financial Problems and Prospects* (by C. F. Haywood) was presented to ABA's Government Relations Council in April 1986. Subsequently, a temporary task force chaired by William T. McConnell, president, Park National Bank, Newark, Ohio, was established to consider the implications of the FSLIC's insolvency. The findings of the task force were reported in *The FSLIC Problem: Implications for Commercial Banks*, released internally in January 1988.

With evidence mounting that the August 1987 FSLIC recapitalization plan would be insufficient, the ABA established a permanent monitoring entity, the FSLIC Oversight Committee, in early 1988. Under the chairmanship of William McConnell, the committee was organized to provide a continuing forum for discussion and deliberation within ABA on actions needed to:

- remedy the FSLIC's insolvency;
- quarantine those insolvent and weak FSLIC-insured thrift institutions that have little or no prospect of regaining financial viability; and
- prevent the recurrence of insolvency in the FSLIC.

The work of the FSLIC Oversight Committee has led it to conclude that efforts to resolve the FSLIC/thrift industry problem must look beyond the immediate financial dimensions of the FSLIC's insolvency and also focus on the underlying causes. Viewed in this light, the most important issues are those relating to regulatory, supervisory, and accounting deficiencies in the thrift industry; risks arising from a national policy of mandating specialized lending institutions; and the lack of market discipline under the present structure of the deposit insurance system.

In this context, the FSLIC Oversight Committee urges that resolution of the thrift industry crisis be guided by nine specific principles. Each of these principles is set forth and discussed below.

B. The FSLIC Insolvency is Largely the Result of Inadequate FHLBB Regulation and Supervision

Heavy reliance on fixed-rate mortgages has always made thrift institutions vulnerable to rising interest rates. As interest rates rose in the late 1970s and early 1980s, the market value of thrift institution mortgage portfolios plummeted. At the interest rate peak in 1981, thrift institutions were technically insolvent on a market value basis by perhaps as much as $100 billion.

Believing the troubles of the thrifts to be a temporary result of high interest rates, the FHLBB and Congress gave their approval to a variety of forbearance and regulatory accounting procedures (RAP) which depicted a more positive net worth for these institutions. However, these measures -- including net worth certificates, deferred losses on asset sales, and favorable accounting treatment in acquisitions of failing institutions -- offered only a cosmetic solution.

The loosening of accounting standards created a situation which allowed thrifts with little or no true net worth to continue to operate. Many of these FSLIC-insured thrifts, in an effort to increase their profitability, took on high-risk assets seeking higher returns. There are numerous reported cases of financing of real estate projects that were never built and land loans based upon inflated appraisals. Some FSLIC-insured thrifts have gambled on swings in interest rates by purposely taking excessive mismatched asset and liability positions. Still other insolvent or weak institutions have resorted to rapid deposit growth as a way to pay personnel and other operating expenses.

While no system of regulation and supervision is able to prevent all unsafe and unsound practices or detect all fraud and insider abuse, the considered judgment of the FSLIC Oversight Committee is that the failure of the FHLBB to adequately supervise and regulate the thrift industry contributed materially to its insolvency. It is in error to think that deregulation of deposit interest rates and the related expansion of thrift powers in the early 1980s caused the FSLIC's insolvency. The weakness that condemned the FSLIC to insolvency was the FHLBB's failure to strengthen its examination and supervisory policies and personnel to handle the riskier, rapidly growing portfolios of FSLIC-insured thrifts. Equally important, the FHLBB failed to close down institutions promptly once they were recognized as insolvent. Rather, these insolvent thrifts continued to operate in a way that only worsened their financial condition and imposed additional losses on the FSLIC.

The FHLBB's failure to act is due, in part, to its chartered mandate to promote housing through FSLIC-insured thrift institutions. This helps explain why the FSLIC did not act as aggressively as it should have in closing or merging failing institutions. It also helps explain how industry leaders exercised -- and continue to exercise -- considerable control over the regulators, creating loosely regulated FSLIC-insured thrifts.

C. Thrift Institution Regulation Should be Brought up to the Level of Commercial Bank Regulation

Except for the direct-investment authorities of some state-chartered thrifts, the activities of FDIC-insured banks and FSLIC-insured thrifts have become quite similar. The supervision and regulation, however, have not. The Federal Home Loan Bank System has been slow to upgrade its resources from those necessary to regulate and supervise a special purpose industry to the kind needed to oversee institutions that offer a broad array of banking products in an environment of volatile financial markets. It is clear that FSLIC-insured thrift institutions need to be brought under regulatory standards no less exacting than those governing banks. This will require both reforming thrift regulatory practices and freeing thrift regulators from the legislative mandate

to promote housing through the regulation of savings and loan associations. These steps must be taken to ensure that the current crisis will not recur.

No system of regulation is without its flaws. In contrast to the regulation of FSLIC-insured thrifts, however, banking regulation and supervision has been thorough, swift, and professional. When threats to safety and soundness have been detected, corrective actions have been promptly initiated. Insolvent banks have been closed and liquidated or reorganized as quickly as possible. Other key differences reflecting special treatment of thrifts include:

- lower capital requirements;
- lower liquidity requirements;
- liberal lending limits on real estate loans;
- access to Federal Home Loan Bank advances;
- deferral of loan losses;
- larger tax-free transfers to loan-loss reserves;
- special treatment of tax-loss carry-forwards;
- revaluation of premises and other property;
- recording mutual fund assets at cost, not market;
- liberal valuation of intangible assets; and
- less frequent use of enforcement actions by regulatory authorities.

To be sure, individual banks have gotten into difficulty, as have even many banks in a whole region, such as the present problems in the Southwest. But, the regulation of FDIC-insured institutions has helped ensure that the banking industry as a whole is profitable, adequately capitalized, well managed, and fundamentally sound.

The differences between bank and thrift regulatory treatment, in the judgment of the FSLIC Oversight Committee, explain in large part why the FDIC is solvent and the FSLIC is insolvent. It is essential that differences in regulation and supervision be eliminated. The Federal Financial Institutions Examination Council is an ideal forum to research and document the differences between thrifts and bank regulatory, supervisory, and accounting practices as a basis for formulating a program for correction of deficiencies.

To achieve effective regulation of thrift institutions, the FHLBB staff of examiners and general regulatory personnel must be strengthened. Under the present FHLBB administration some improvement in staff capabilities is already discernible. Many new FHLBB staff, however, were attracted away from banking regulatory agencies, notably the Office of the Comptroller of the Currency and the FDIC. This raises the question of the appropriateness of agencies competing for talent. It is important to monitor salary differentials between these public agencies to ensure that one regulatory agency is not operating in such a manner as to disadvantage another agency.

Other changes must take place to restore the meaningfulness of net income and capital positions as buffers to absorb losses in individual institutions. This is best accomplished by imposing rigorous capital and accounting standards for FSLIC-insured institutions.

D. The FSLIC Insolvency is Growing Rapidly

The depth of the FSLIC's insolvency has been repeatedly and seriously underestimated. In the early 1980s, regulators believed that the thrift industry's problems were the result of temporarily high interest rates. Attempting to recover from the interest rate shock, the quality of many thrifts' assets deteriorated as they took on higher risk, higher interest rate assets. There was an emerging recognition of an "FSLIC problem" during 1985. At that time, it was thought that the problem could be resolved in a few years with the use of special insurance assessments. By early 1986, the FSLIC problem worsened to the point where the special assessment was seen as a burden that the industry would likely have to endure for at least five years; additional funds beyond the special assessment would also be needed. In mid-year 1987 the Congress authorized additional funds through the recapitalization program, but by the time the legislation was passed the problem had deteriorated to the point where the recapitalization was widely viewed as being only a temporary palliative.[1]

By year-end 1987, the insolvency of the FSLIC was estimated to be in the range of $30 billion to $60 billion.[2] The magnitude of the FSLIC's insolvency has continued to grow this year at a dramatic pace. Based upon the liquidation experience for the first half of 1988, the FSLIC Oversight Committee estimates that the FSLIC's net worth at mid-year was a negative $74 billion (see Tables 1 and 2). Other estimates go as high as $100 billion.

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[1] Underestimation of the depth of the FSLIC's insolvency has reflected unrealistic assumptions about the number of insolvent institutions and the extent of the losses in them. The policy of keeping insolvent institutions open has also proved to be very costly and such costs have not been realistically projected.

[2] Estimates in this range are well documented. For example, in testimony before the Senate Banking Committee on May 19, 1988, Frederick Wolfe (GAO) and William Ferguson (Ferguson & Company) stated that the actual 1987 deficit net worth of the FSLIC was $30 billion to $35 billion. Stuart Greenbaum (Northwestern University) and Stanley Silverberg (Golembe Associates) testified separately that the FSLIC's negative net worth was as large as $50 billion, and Bert Ely (Ely & Company) testified that the insolvency was $64 billion at year-end 1987.

Even more disturbing is the degree of insolvency five or ten years out if nothing is done to increase the pace of liquidations (see Table 3). At year-end 1987, 508 FSLIC-insured thrifts were insolvent on a generally accepted accounting principles (GAAP) basis and the FSLIC's book net worth excluding reserves for unresolved cases was a positive $3.7 billion.[3] At the current rate of 118 failure resolutions per year, the FSLIC's insolvency is projected to be a negative $9 billion by the end of this year, even without including reserves for losses on case resolutions. By year-end 1989, liabilities would exceed assets by $29 billion, an additional loss of $20 billion. In the four years that it would take to deal with the 508 insolvent thrifts, book value net worth would become more negative by an average of $20 billion each year. At the end of four years, the negative book net worth would be over $78 billion.

As dramatic as these numbers are, they may understate the ultimate cost since they are based upon the assumptions that:

- no other thrifts become insolvent; and
- the cost to the FSLIC, as a percent of assets, of closing or financially assisting mergers of failed thrifts does not continue to increase.

Unfortunately, these assumptions may not hold. Many additional thrifts, while solvent, have very low capital. For example, as of year-end 1987, over 400 FSLIC-insured thrifts had capital-to-assets ratios of less than three percent. Furthermore, according to thrift-consultant William Ferguson, 169 of these institutions are likely to become insolvent in the very near future. If these additional thrifts are factored in,[4] the FSLIC's book net worth would deteriorate until the year 1995 (see Table 4). At that time, liabilities excluding case reserves would exceed assets by over $105 billion. This also suggests that on a net present value basis and with no change in the pace of failure resolutions, the FSLIC's negative net worth would remain above $100 billion for over a decade.

The cost also would be greater to the FSLIC the longer insolvent thrift institutions are allowed to operate. In the first eight months of this year, the cost of liquidating or assisting a failed thrift (on a net present value basis) averaged 49.7 cents per dollar of assets. This is in contrast to the average cost of 32.7 cents per dollar recorded in 1987 and reflects a steady climb over the last four years (see Figure 1). Moreover, experience has shown that as insolvent institutions continue to operate the value of their assets continues to decline. In more than a few instances, the FSLIC's cost of closing a thrift has exceeded 100 cents per dollar of assets (see Table 2).

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[3] The number of insolvent FSLIC-insured thrift institutions was based upon the testimony of William C. Ferguson before the Senate Committee on Banking, Housing, and Urban Affairs, May 19, 1988.

[4] These nearly-insolvent thrifts are assumed to fail at a rate of twelve percent per year, based upon a GAO finding (May 1987).

Continued deterioration of thrift industry conditions suggests even higher rates of insolvencies for FSLIC-insured thrift institutions. This is reflected in the continued and severe losses in the industry. For example, in 1987 the net income for the industry was a negative $6.8 billion. Much of this overall loss -- $3.8 billion -- was in the fourth quarter of 1987. Identical losses were experienced in the first quarter of 1988.

This grim condition comes at a time when the U.S. economy in general would be regarded as favorable to the thrift industry. Less favorable economic and financial market trends, including rising interest rates which are already occurring, could bring an even greater disaster to the thrift industry. The importance of these economic trends cannot be minimized. Nonetheless, a greater threat to the health of all depository institutions is the continued operation of insolvent or nearly-insolvent FSLIC-insured thrifts.

E. Insolvent Thrifts Must Be Liquidated

In the view of the FSLIC Oversight Committee the rapid escalation of the FSLIC insolvency can be meaningfully reduced only by closing or merging the bankrupt FSLIC-insured thrifts at a much faster pace. The efforts by the current FHLBB administration to increase the pace of case resolutions over the last few weeks is very encouraging. Hopefully, these efforts mark a new era of commitment to dissolving or merging insolvent thrift institutions at a much more rapid pace. However, equally important to increasing the pace of case resolutions is the need to ensure that sufficient resources are brought into assisted transactions of failed thrifts so that the reconstituted institutions have the capital necessary for a reasonable chance of success. Merging insolvent with nearly-insolvent institutions without sufficient backing may only create bigger problems with greater costs to the FSLIC in the near future.

Increasing the pace of liquidation will save billions of dollars. This can be illustrated by projecting FSLIC's booked net worth over time (see Figure 2). While more expenses would need to be booked over the next few years as a result of the increased pace, savings from this action would be clearly visible in later years. In fact, in net present value terms, the FSLIC's negative net worth would be reduced by more than $2 billion by the end of this year and by $10 billion ten years from now (see Table 5). Perhaps more startling is that while the FSLIC's negative net income before unresolved case loss provisions would triple in 1989, its overall loss (including provisions) would actually decrease nearly fifty percent due to anticipated future savings. Additional savings to society are also likely to arise from an increased pace of liquidation.

The current FHLBB administration should be commended for its efforts to improve standards and staff capabilities. More needs to be done, however. Maintaining a rapid pace of payoffs or assisted mergers will require substantial resources -- human and financial. It is imperative that financial constraints on the pace of liquidating bankrupt thrift institutions be eliminated. The Federal Home Loan Bank Board should be prepared to exercise full and prompt use of the present FSLIC recapitalization plan resources.

Equally important, any constraints on personnel resources and administrative procedures used in the liquidation of insolvent FSLIC-insured thrifts must also be eliminated at the earliest possible time. While the FHLBB should continue its efforts to augment its liquidation personnel and administrative resources, such improvements should not be accomplished by raiding the personnel of the banking regulatory agencies. To alleviate temporary needs for manpower, arrangements can be made for temporary details of staff from the banking regulatory agencies. This coordinated effort can be accomplished without sapping key personnel from the banking agencies. Ways should also be explored of bringing in additional personnel from private accounting firms or other private sources on a temporary basis to help deal with the present FSLIC emergency.

FHLBB efforts to arrange for the acquisition of troubled thrift institutions are significantly facilitated by the current tax law provisions which make the FSLIC's assistance tax free to the institution and which permit the carryover of losses to the new ownership to offset future earnings. If Congress extends these provisions, which are scheduled to expire at the end of 1988, the FHLBB will be able to resolve cases more quickly than if each acquiring institution had to structure the transaction to avoid tax pitfalls and then apply for a ruling from the Internal Revenue Service. The savings to the FSLIC fund in terms of reduced cash assistance paid to the acquiring institutions will offset the revenue cost of these tax provisions. In light of the current crisis at the FSLIC, it would be unwise to throw the taxation of thrift acquisition transactions into doubt.

Methods of increasing the capital of thrift institutions should also be explored including enabling bank holding companies to purchase and operate FSLIC-insured thrifts.

In most cases curtailing losses requires that strict controls be placed on growth, new lending, and other activities of insolvent or nearly-insolvent thrifts. For example, the following controls should be put in place for insolvent and low-capitalized thrifts:

- Limits on the growth of deposits.
- No additional borrowings from the FHLBB, except under emergency conditions pending prompt formal liquidation.
- Limits on the use of brokered deposits. Since many institutions rely on these funds to cover operating expenses, stoppage of these funds entirely would force immediate closure of these institutions. Clearly, these institutions should be closed quickly; in the meantime, the use of brokered deposits should be cut back according to an established and immutable schedule.
- Limits on the growth of assets. Funds received from the repayment of (amortized) loans should be used to pay down existing market deposits (e.g., brokered deposits).
- No loans to new customers.
- No loans to officers or directors of the thrifts. This would include former officers and directors who have been replaced by regulatory action.

F. Additional Funds Will Be Needed

The clear lesson from the history of financial crises is that resolution is aided by demonstrating that sufficient funds are available to resolve the crisis at hand. With the worsening of the thrift industry crisis, it is imperative that the amount of money needed to resolve the problem not be underestimated again.

The funds available from the FSLIC recapitalization plan, including premiums paid by FSLIC-insured thrift institutions, appear to be insufficient to resolve the FSLIC problem. In the judgment of the FSLIC Oversight Committee, consideration needs to be given now to developing a broader framework for funding the resolution of the FSLIC problem. Although all other reasonable and equitable funding options should be explored, the use of taxpayer funds and/or the Treasury's credit now appears unavoidable.

G. Use of FDIC Resources Would Be Unrealistic and Unwise

Suggestions have been made that any additional resources needed by the FSLIC should be obtained from the FDIC. Several considerations argue strongly against such an approach.

The FSLIC's insolvency is a problem that affects the entire nation. Given the FSLIC's basic structure as a mutual insurance system, it was appropriate to try to solve its problems by first drawing on the resources of its own members, as provided under the recapitalization plan enacted last year. But when those "internal" resources prove inadequate and additional funding must be obtained from "external" sources, as now appears to be the case, the appropriate source for the needed additional funds clearly is society as a whole.

This was precisely the approach taken this summer in providing relief for farmers whose crops suffered from the effects of the drought, and it has also been followed regularly in assisting victims of earthquakes, floods, or other natural disasters. The aim of these programs has been to spread the costs of assistance as widely as possible, so that no single group would bear an inordinate burden. Obtaining funds for the FSLIC from the FDIC, whose resources come from the premiums paid by commercial banks, would concentrate the cost of FSLIC assistance on just a narrow segment of our society, and thus run completely contrary to the principles followed in other national assistance programs.

Furthermore, the banking industry has not been responsible for the condition of the thrift industry or its deposit insurer and should not be required to bear the cost of their rescue. For more than twenty years, commercial banks have been adversely affected by the problems of the thrift industry. Over this period legislation has been passed giving to thrift institutions explicit advantages in competing with commercial banks. Moreover, the problems of the savings and loan industry have been used to justify expanded powers and less restrictive regulation for savings and loan associations and to justify continuation of restrictive regulation of commercial banking organizations. It is unfair after two decades of favored treatment over the banking industry that bank premiums would be used to bail out banks' competitors.

From a purely practical viewpoint as well, there simply are not enough funds available in the FDIC to cover the whole of the FSLIC problem. Even with $18 billion, the FDIC fund would be quickly consumed without halting the crisis. Moreover, regional economic problems have already put strains on the FDIC fund. These have created record bank failures in each of the last two years and may set a new record again this year. The result has been to reduce the ratio of the FDIC fund per dollar of insured deposits to its lowest point in history (see Figure 3). While the FDIC fund is still adequate to resolve the problems of banks in economically distressed areas of the country, it is clearly not sufficient to cover the problems of insolvent thrifts as well.

The record number of failures has had another consequence. It has forced the FDIC to eliminate rebates on bank premiums, and FDIC Chairman William Seidman has stated that it is likely that rebates will not be reinstated for several years until the regional economic problems improve. While bankers can accept the cost of resolving failures in their own industry, it is deeply disturbing to contemplate the possibility that banks would have to continue to pay premiums for perhaps decades in order to pay for the irresponsible actions of their thrift industry competitors and mistakes of thrift regulation and supervision.

While the distinction between thrifts and banks may disappear in the future, it does not justify usurping the funds of one industry to bail out another no matter how convenient and expedient that solution might seem to be. Furthermore, spending FDIC resources on the thrift problem could place the FDIC in insolvency, exposing the whole depository system to a loss of public confidence.

H. A Limited-Life Liquidation Trust May Be Needed

Since the FHLBB resources are insufficient to bring the growth of the FSLIC insolvency under control quickly, a new mechanism must be put in place to provide for expeditious closing of insolvent institutions while preserving the integrity of the deposit insurance system. In the FSLIC Oversight Committee's judgment, consideration should be given to some form of liquidating trust or corporation, established by Congress, to take control of insolvent savings and loan associations.

The foremost purpose of the corporation would be to arrange for all insolvent institutions to be liquidated or acquired by healthy financial institutions. In cases where assets of insolvent institutions had to be liquidated, it would also be responsible for seeing that the liquidations were conducted in an orderly and timely manner.

Only GAAP insolvent thrift institutions as of the date of enactment of the statute creating it would be handled by the limited-life liquidation trust. Any other FSLIC-insured thrift institution that became insolvent after this date would be handled by the FSLIC under normal operating procedures.

When all of the insolvent institutions have been merged or liquidated, and their assets disposed of, the corporation would go out of business. An outside limit on its life should be established (perhaps ten years) to assure that the corporation does not become a vehicle for promoting new activities. Use of the corporation's resources should be restricted to properties of closed institutions; that is, its resources should not be used to allow operating thrifts to avoid write-downs or to dump bad loans.

The corporation would be empowered to choose the most economical method of disposing of thrifts under its control, either merging them with healthy depository institutions, arranging purchase and assumption transactions, or paying off depositors and assuming the assets of the bankrupt thrifts. These assets should be sold over time in a manner that does not disrupt markets for loans or property.

Because there are so many insolvent thrifts, the liquidating corporation should be empowered to appoint trustees to act on its behalf in overseeing management and arranging liquidations. If trustees were appointed, they would have to present their proposals for payoffs or assisted mergers to the corporation for approval.

Financial arrangements for the corporation would need to be carefully designed since not all insolvent institutions can be closed and paid off immediately. Funds must be available to pay the liquidation corporation's ongoing costs and its losses as it disposes of assets acquired in the process of liquidating (or arranging for assisted mergers) of insolvent FSLIC-insured thrifts over time. The corporation's enabling legislation should provide for government funding of operating costs.

Finally, it is important to make a distinction between the corporation and the Federal Asset Disposition Association (FADA). Unlike the FADA, the liquidating trust would operate independently of the FSLIC and the Federal Home Loan Bank System. Moreover, it would be accountable to Congress, subject to audit by the General Accounting Office and required to report regularly on its progress. Liquidation Trust personnel would also be subject to the Code of Ethics used by all other government agencies and its management would not be allowed, as the management of FADA did, to write its own self-serving "Business Code of Ethics." Unlike FADA, the corporation would also be empowered to sell insolvent thrifts as existing entities rather than just marketing individual assets.

I. Housing Finance Incentives Need Reconsideration

The historic role of thrifts as specialized lenders has eroded substantially, and the structure of housing finance markets has changed markedly since the mid-1960s. Significant innovations have been made in the origination process for residential mortgage loans, and new structures, especially secondary market mechanisms, have evolved. A thorough review and evaluation should be undertaken of the existing system of incentives to specialized housing lenders and the role of the FHLBB and the Federal Home Loan Banks. It may be that the Federal Home Loan Bank System is not as relevant to the national needs for housing finance as it was 50 years ago or even 20 years ago.

The role of FSLIC-insured thrift institutions in financing housing has been used to rationalize low capital requirements, minimal liquidity requirements, easy access to capital-market funding through Federal Home Loan Bank advances, departures from generally accepted accounting principles, expansion of asset powers, special tax benefits, and other aspects of "cheerleader" regulation. Some degree of favored treatment may have been justified from the 1930s through the 1950s as the nation's housing industry was affected by depression, war, and a large postwar demand for housing. After the mid-1960s, however, favored treatment served mainly to put off the day when FSLIC-insured thrifts would have to face up to the discipline of operating in competitive markets. This postponement strategy has become too expensive to be maintained.

Favored treatment of FSLIC-insured thrifts appealed to some policy makers as a way of subsidizing housing with little or no cost in terms of direct federal outlays. But experience has again confirmed that there can be no free lunch. The bill for favored treatment of the thrift industry has now come due in the form of the FSLIC's insolvency. The thrift industry crisis makes it especially important that we reconsider whether special incentives for housing finance are needed, and if so, what is the most efficient means of providing them in today's financial marketplace.

J. The Maintenance of Market Discipline in Deposit Insurance is Needed

In addition to the absence of effective regulatory restraint and reliance on brokered deposits, de facto 100 percent deposit insurance has encouraged thrift managers to take excessive risks. Depositors and other creditors of depository institutions have no incentive to force discipline on officers and directors of the institutions when their interests are fully protected. This has led some managers, many of whom are running insolvent or nearly insolvent thrifts, to take inappropriate and excessive risks knowing that the down-side exposure would fall on the FSLIC. It is important that these abuses of the deposit insurance system be corrected. Improvements in supervision, regulation and examination will help in this cause.

This may not be enough. It is important that the policing of abuses in depository institutions not be the sole responsibility of regulators and deposit insurers. Market forces should play a greater role in preventing mismanagement and undue risk-taking. The basic idea is simple: the management of individual financial institutions should be subject to the same kind of policing that banks and other creditors apply to those to whom they extend credit. They should also be subject to the disciplining influences of owners who have substantial capital committed to those institutions.

The operation of market discipline in policing the management of depository institutions has been unnecessarily blunted by government policies. It is widely believed that the government safety net will be used to provide de facto 100 percent insurance to all depositors, no matter how large their deposit balances. In fact, the safety net has on occasion been extended even further to cover holders of non-deposit claims on banks, including even subordinated debt holders. The interests of owners of banks -- including bank holding companies -- have also been protected, as have the interests of creditors of bank holding companies.

It is obvious to all that protecting owners of banks, or creditors of companies that own banks, leaves little room for market discipline. Recent actions and pronouncements of the FDIC indicate it will not allow its resources to be diverted to bailing out owners of banks and their creditors. This is a welcome development, for it not only assures that the resources of the FDIC will not be misapplied, but that stockholders of banks and their creditors will recognize clearly that the safety net is not intended to rescue them from mistakes.

It may be desirable to carry the campaign for increased market discipline even further. By redesigning the safety net to make it clear that subordinated debt is not protected by government regulation, private investors in this debt would do a better job of denying, or putting a very high price on, credit to FSLIC-insured thrifts and FDIC-insured banks whose operations do not meet their tests of safety and soundness. Finally, any reform of the deposit insurance system should have as a principal goal fair and consistent treatment of depository institutions, regardless of size. It may be desirable for the FSLIC and the FDIC to adopt policies that remove any presumption of de facto 100 percent insurance of depositors, regardless of the size of depository institution in which these funds are placed.

It should be noted that thrifts and banks themselves, as major players in the interbank market, are positioned to play a key role providing the kind of improved market discipline that is needed to supplement the efforts of the regulatory authorities. They will perform most effectively if they know that their claims on other banks and thrifts are not, in effect, 100 percent insured.

Table 1

Estimated Net Worth of the Federal Savings and Loan Insurance Corporation[1]

June 30, 1988

Summary Income Statement for 6 Months Ended June 30, 1988	$1000s
Insurance premiums[2]	395,285
Special assessment premiums[2]	592,927
Interest on securities[3]	83,714
Interest on advances[4]	4,449
Interest on other loans to institutions[5]	37,291
Interest on capital certificates[6]	27,589
Other income[7]	53,594
Gross Income	1,194,849
Operating expenses[3]	109,186
Interest on notes payable[3]	139,489
Case resolution costs and provision, npv[8]	4,711,400
Expenses before unresolved case provisions	4,960,074
Net Income before provisions for unresolved cases	(3,765,225)
Provisions for Unresolved Cases[9]	26,558,220
Net Income	(30,323,445)

Summary Balance Sheet for June 30, 1988	$1000s
Assets[10]	10,826,133
Liabilities excluding reserves for unresolved cases[11]	10,881,578
Net Worth excluding reserves for unresolved cases	(55,445)
Reserves Against Loss on Unresolved Cases[9]	73,710,409
Net Worth including reserves for unresolved cases[12]	(73,765,854)

[1] 508 thrifts were insolvent under generally accepted accounting principles at the end of 1987 according to William C. Ferguson, "Presentation to the Senate Committee on Banking, Housing, and Urban Affairs," May 19, 1988. This table assumes that 465 of these institutions remained to be liquidated or merged after the Federal Home Loan Bank Board liquidated or merged 43 thrifts in the first half of the 1988. This implies that no additional thrifts became insolvent and no insolvent thrifts returned to solvency.

[2] Calculated as half the annual premiums on projected deposits of one twelfth percent for regular premiums and one eighth percent for special assessments.

[3] This value is one half of the 1988 figure projected by the Federal Home Loan Bank Board in M. Danny Wall's July 7, 1988, testimony before the Committee on Banking, Finance and Urban Affairs, U. S. House of Representatives.

[4] This is projected to grow from the 1986-87 average in proportion to deposits

[5] This reflects half of 1988 interest on $1,114.2 million loans to institutions amortized from 1988 to 1995, as per GAO's 1987 FSLIC Audit.

[6] This is projected to drop from the 1987 level in proportion to the number of unresolved thrift cases.

[7] This is projected to grow five percent per year as suggested in Wall (1988).

[8] This reflects the projected net present value cost of the 43 case resolutions in the first half of 1988 according to press releases from the Federal Home Loan Bank Board.

[9] Reserves are calculated as the net present value of the projected cost of resolving the remaining insolvent thrift cases based on the first-half 1988 case resolution rate, net present value cost rates through August 12, and a seven percent 1987 net income loss rate for the 508 insolvent thrifts (according to Ferguson, ibid.). Provisions are equal to the addition to end-of-1987 reserves.

[10] Assets are projected to grow in proportion to thrift industry deposits.

[11] Calculated as projected assets minus net worth and reserves against unresolved case losses.

[12] Calculated as end-of-1987 net worth plus first six months' net income.

Table 2

FSLIC Case Resolutions Through June 30, 1988

	Date Closed	Institution	Assets ($mills)	Cost ($mills)	Loss Ratio
		Insured Deposit Payoffs			
1	1-15-88	First Savings Assoc. of E. Texas	62.9	86.7	1.378
2	1-29-88	Territory S&L Association	37.8	52.0	1.376
3	1-29-88	Citizens S&L Association	150.0	135.0	0.900
4	2-26-88	Mt. Whitney S&L Association	33.7	46.4	1.377
5	2-26-88	Ramona Federal S&L Association	44.6	76.3	1.711
6	3-11-88	First Federal S&L Assoc., Ky.	130.0	52.3	0.402
7	3-25-88	Investors S&L Association	81.1	87.6	1.080
8	3-25-88	United Savings	86.5	76.3	0.882
9	4-08-88	First Federal S&L Assoc., Ok.	128.8	138.2	1.073
10	4-29-88	American Federal S&L Association	164.4	67.2	0.409
11	5-13-88	Cardinal Savings Bank, N. C.	93.8	34.4	0.367
12	6-03-88	LaRue Federal S & L Assoc., Ky.	13.1	6.6	0.504
13	6-06-88	North American S & L Assoc., Ca.	98.2	133.0	1.354
14	6-06-88	Amer. Diversified Sav. Bank, Ca.	509.0	798.0	1.568
		TOTAL to June 30, 1988	1,633.9	1,790.0	1.096
		Assisted Acquisitions and Mergers			
1	1-27-88	First Federal S&L., Ill	31.1	10.2	0.328
2	2-10-88	Magnet Bank, F.S.B., WVa.	547.1		
3	2-10-88	Traders Federal S&L, WVa.	71.5	81.5	0.132
4	2-10-88	Mountain State Federal S&L, WVa.	91.4		
5	2-10-88	First Federal S&L of Craig. Co.	30.9	3.8	0.031
6	3-04-88	First Federated S&L, Fla.	142.7		
7	3-11-88	Perpetual S&L, Iowa	118.9		
8	3-11-88	First Federal Savings Bank, Iowa	152.4	157.0	0.277
9	3-11-88	Peoples Federal S&L, Iowa	152.4		
10	3-11-88	Tri-Cities S&L, Wa.	54.5	15.8	0.076
11	4-08-88	Citizens S&L, Ill.	39.0	6.1	0.156
12	4-11-88	Valley Federal S&L, Tenn.	87.5	7.1	0.081
13	4-12-88	Alliance S & L, Tx	103.7		
14	5-13-88	Colorado Country Fed. S & L, Tx.	216.1		
15	5-13-88	Security S & L, Tx.	108.3		
16	5-13-88	Cameron County S & L, Tx.	27.7	138.3	0.303
17	5-13-88	Lamar Savings Assoc., Tx.	1,900.0		
18	5-18-88	City Savings & Loan Assoc., Tx.	687.3		
19	5-18-88	Stockton Savings Assoc., Tx.	543.0		
20	5-18-88	Briercroft Savings Assoc., Tx.	868.1	2,000.0	0.500
21	5-18-88	Bluebonnet Savings Assoc. of Tx.	24.1	9.9	0.411
22	5-26-88	1st Fed S & L of Hammonton, NJ	245.5	72.1	0.294
23	5-27-88	Eureka Fed S & L, Ca.	1,740.0	304.0	0.175
24	5-27-88	Frontier Fed Sav Bank, Tenn.	46.2	11.0	0.238
25	6-06-88	First Financial, Tx.	329.8		
26	6-22-88	Brownfield Fed S & L Assoc., Tx.	40.2	83.9	0.227
27	6-22-88	Muskegon Fed S & L, Mi.	202.0	4.0	0.020
28	6-22-88	Stanford S & L Assoc., Ca.	76.5	7.6	0.099
29	6-24-88	Lynnwood S & L Assoc., Wash.	24.6	9.2	0.372
		TOTAL to June 30, 1988	8,702.5	2,921.4	0.336
		GRAND TOTAL to June 30, 1988	10,336.4	4,711.4	0.456

Table 3

Projected Net Worth of the Federal Savings and Loan Insurance Corporation

	-------------	-------------	-------------	-------------	-------------	Millions of Dollars	-------------	-------------	-------------	-------------	-------------	-------------
Year or End of Year ->	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Number of Unresolved Cases[1]	508	390	272	154	36	0	0	0	0	0	0	0
Income[2]	2,395	2,449	2,427	2,549	2,673	2,814	2,948	3,115	3,313	3,530	3,768	4,024
Expenses excluding unres. case prov's[3]	4,051	15,224	22,663	25,570	28,530	10,303	1,088	860	727	591	465	327
Net Income before unres. case prov's	(1,656)	(12,775)	(20,237)	(23,022)	(25,857)	(7,489)	1,861	2,254	2,587	2,940	3,304	3,697
Provisions for Unresolved Cases[4]	13,547	24,255	(16,223)	(20,653)	(25,608)	(8,923)	0	0	0	0	0	0
Net Income	(15,203)	(37,030)	(4,013)	(2,369)	(249)	1,434	1,861	2,254	2,587	2,940	3,304	3,697
Assets[5]	10,508	11,154	11,844	12,597	13,416	14,338	15,342	16,416	17,565	18,794	20,110	21,518
Liabilities excluding unres. case res[6]	6,799	20,219	41,146	64,920	91,597	100,008	99,151	97,970	96,533	94,823	92,834	90,544
Net Worth excluding unres. case res's	3,710	(9,065)	(29,302)	(52,323)	(78,181)	(85,670)	(83,809)	(81,555)	(78,968)	(76,028)	(72,724)	(69,027)
Reserves Against Loss on Unres. Cases[4]	47,152	71,407	55,184	34,531	8,923	0	0	0	0	0	0	0
Net Worth including unres. case res's[7]	(43,442)	(80,472)	(84,485)	(86,854)	(87,103)	(85,670)	(83,809)	(81,555)	(78,968)	(76,028)	(72,726)	(69,027)

Sources: Federal Home Loan Bank Board, press releases in 1988; William C. Ferguson, "Presentation to the Senate Committee on Banking, Housing, and Urban Affairs," May 19, 1988; U. S. General Accounting Office, Financial Audit: Federal Savings and Loan Insurance Corporation's 1987 and 1986 Financial Statements, GAO/AFMD-88-58, July 1988; and M. Danny Wall, "Federal Savings and Loan Insurance Corporation Pro Forma Estimated Budget Outlays and Cash Flows: Fiscal Years 1988 - 1998," prepared for testimony before the Committee on Banking, Finance and Urban Affairs, U. S. House of Representatives, July 7, 1988.

1 Seventy-nine insolvent thrifts were either liquidated or merged with solvent institutions through August 1988, implying a rate of 118 case resolutions per year. This analysis assumes that no additional thrifts become insolvent and no insolvent thrifts return to solvency during 1988 so that 429 of the 508 thrifts which were insolvent under generally accepted accounting principles as of year-end 1987 (see Ferguson (1988)) remained to be liquidated or merged.

2 This figure includes the following: A charge of one twelfth of one percent for deposit insurance premiums and one eighth of one percent for special assessments are assessed on average projected deposits; Assets of solvent thrifts are projected to grow seven percent per year, in line with Wall (1988), and assets of insolvent thrifts are assumed to grow at the 1987 rate of 1.9% per year, as per Ferguson (1988); The ratio of deposits to assets is assumed to remain at the year-end 1987 level for solvent and insolvent thrifts, as per Ferguson (1988); Interest on securities is taken from Wall (1988); Interest on advances is projected to grow from the 1986-87 average in proportion to projected deposits; Interest is based on $1,114.2 million of loans to institutions amortized from 1988 to 1995, as per GAO (1988); "Other income" is projected to drop from the 1987 level in proportion to the projected number of unresolved thrift cases.

3 Includes operating expenses and interest on notes payable as projected in Wall (1988), and also includes the net present value projected cost of resolving thrift cases within the year based on the loss rate of 49.7 cents per dollar of asset estimated by the FSLIC for the case resolutions through August 1988 and based on the seven percent net income loss rate for insolvent thrifts in 1987, as reported in Ferguson (1988).

4 Reserves are calculated as the net present value cost of resolving the remaining insolvent thrift cases based on the 49.7 percent average net present cost rate through August 1988 (FHLBB (1988)) and on the seven percent 1987 net income loss rate for insolvent thrifts (according to Ferguson (1988)). Provisions are equal to the addition to end-of-year reserves.

5 Assets are projected to grow in proportion to projected thrift industry deposits.

6 Liabilities excluding unresolved case resolutions are calculated as projected assets minus net worth and unresolved cases reserves.

7 Net worth including unresolved case reserves is calculated as end-of-pridr-year net worth plus the year's net income.

Table 4

Projected Net Worth of the Federal Savings and Loan Insurance Corporation

Twelve Percent Annual Failure Rate of Weak Thrift Institutions

Year or End of Year ->	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
	------	------	------	------	------	Millions	of Dollars	------	------	------	------	------
Number of Unresolved Cases[1]	508	410	309	206	102	13	11	10	9	8	7	7
Income[2]	2,395	2,453	2,435	2,561	2,687	2,821	2,949	3,113	3,308	3,520	3,752	4,001
Expenses excluding unres. case prov's[3]	4,051	15,224	22,663	25,570	28,530	27,118	4,522	3,984	3,776	3,510	3,422	2,766
Net Income before unres. case prov's	(1,656)	(12,771)	(20,228)	(23,010)	(25,843)	(24,297)	(1,572)	(872)	(469)	10	331	1,235
Provisions for Unresolved Cases[4]	13,547	46,735	(14,200)	(18,447)	(23,204)	(13,858)	(2,309)	(2,194)	(2,313)	(2,385)	(2,639)	(2,336)
Net Income	(15,203)	(59,506)	(6,028)	(4,562)	(2,639)	(439)	737	1,322	1,845	2,395	2,970	3,571
Assets[5]	10,508	11,154	11,838	12,578	13,379	14,251	15,226	16,266	17,376	18,560	19,825	21,177
Liabilities excluding unres. case res[6]	6,799	20,215	41,127	64,877	91,521	116,690	119,237	121,149	122,727	123,901	124,836	124,952
Net Worth excluding unres. case res's	3,710	(9,061)	(29,289)	(52,299)	(78,142)	(102,439)	(104,011)	(104,883)	(105,351)	(105,341)	(105,010)	(103,775)
Reserves Against Loss on Unres. Cases[4]	47,152	93,887	79,687	61,239	38,035	14,177	11,868	9,674	7,361	4,976	2,336	0
Net Worth including unres. case res's[7]	(43,442)	(102,948)	(108,976)	(113,539)	(116,177)	(116,616)	(115,879)	(114,557)	(112,712)	(110,317)	(107,347)	(103,775)

Sources: Federal Home Loan Bank Board, press releases in 1988; William C. Ferguson, "Presentation to the Senate Committee on Banking, Housing, and Urban Affairs," May 19, 1988; U. S. General Accounting Office, Thrift Industry: Forbearance for Troubled Institutions: 1982-1986, GGD-87-78BR, May 1987; U. S. General Accounting Office, Financial Audit: Federal Savings and Loan Insurance Corporation's 1987 and 1986 Financial Statements, GAO/AFMD-88-58, July 1988; and M. Danny Wall, "Federal Savings and Loan Insurance Corporation Pro Forma Estimated Budget Outlays and Cash Flows: Fiscal Years 1988 - 1998," prepared for testimony before the Committee on Banking, Finance and Urban Affairs, U. S. House of Representatives, July 7, 1988.

[1] Seventy-nine insolvent thrifts were either liquidated or merged with solvent institutions through August 1988, implying a rate of 118 case resolutions per year. This analysis assumes that no additional thrifts become insolvent and no insolvent thrifts return to solvency during 1988 so that 429 of the 508 thrifts which were insolvent under generally accepted accounting principles as of year-end 1987 (see Ferguson (1988)) remained to be liquidated or merged. In addition, 169 weak thrifts with aggregate assets of $115 billion, identified in Ferguson (1988), are assumed to become insolvent at a rate of twelve percent per year (in line with by US GAO, 1987, page 30).

[2] This figure includes the following: A charge of one twelfth of one percent for deposit insurance premiums and one eighth of one percent for special assessments are assessed on average projected deposits; Assets of solvent thrifts are projected to grow seven percent per year, in line with Wall (1988), and assets of insolvent thrifts are assumed to grow at the 1987 rate of 1.9% per year, as per Ferguson (1988); The ratio of deposits to ussets is assumed to remain at the year-end 1987 level for solvent and insolvent thrifts, as per Ferguson (1988); Interest on securities is taken from Wall (1988); Interest on advances is projected to grow from the 1986-87 average in proportion to projected deposits; Interest is based on $1,114.2 million of loans to institutions amortized from 1988 to 1995, as per GAO (1988); "Other income" is projected to drop from the 1987 level in proportion to the projected number of unresolved thrift cases.

[3] Includes operating expenses and interest on notes payable as projected in Wall (1988), and also includes the net present value projected cost of resolving thrift cases within the year based on the loss rate of 49.7 cents per dollar of asset estimated by the FSLIC for the case resolutions through August 1988 and based on the seven percent net income loss rate for insolvent thrifts in 1987, as reported in Ferguson (1988).

[4] Reserves are calculated as the net present value cost of resolving the remaining insolvent thrift cases based on the 49.7 percent average net present cost rate through August 1988 (FHLBB (1988)) and on the seven percent 1987 net income loss rate for insolvent thrifts (according to Ferguson (1988)). Provisions are equal to the addition to end-of-year reserves.

[5] Assets are projected to grow in proportion to projected thrift industry deposits.

[6] Liabilities excluding unresolved case reolutions are calculated as projected assets minus net worth and unresolved cases reserves.

[7] Net worth including unresolved case reserves is calculated as end-of-prior-year net worth plus the year's net income.

Table 5
Projected Net Worth of the Federal Savings and Loan Insurance Corporation
Tripling the 1988 Pace of Insolvent Thrift Case Resolution

Millions of Dollars

Year or End of Year ->	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Number of Unresolved Cases[1]	508	390	34	0	0	0	0	0	0	0	0	0
Income[2]	2,395	2,449	2,399	2,517	2,665	2,821	2,959	3,126	3,325	3,543	3,782	4,039
Expenses excluding unres. case prov's[3]	4,051	15,224	66,052	8,515	1,025	987	1,088	860	727	591	465	327
Net Income before unres. case prov's	(1,656)	(12,775)	(63,653)	(5,997)	1,640	1,833	1,871	2,265	2,598	2,953	3,318	3,712
Provisions for Unresolved Cases[4]	13,547	21,762	(61,747)	(7,167)	0	0	0	0	0	0	0	0
Net Income	(15,203)	(34,537)	(1,906)	1,170	1,640	1,833	1,871	2,265	2,598	2,953	3,318	3,712
Assets[5]	10,508	11,154	11,765	12,571	13,451	14,393	15,401	16,479	17,632	18,866	20,187	21,600
Liabilities excluding unres. case res[6]	6,798	20,219	84,483	91,287	90,527	89,635	88,772	87,584	86,139	84,421	82,424	80,125
Net Worth excluding unres. case res's	3,710	(9,065)	(72,718)	(78,715)	(77,075)	(75,242)	(73,371)	(71,106)	(68,507)	(65,555)	(62,237)	(58,525)
Reserves Against Loss on Unres. Cases[4]	47,152	68,915	7,167	0	0	0	0	0	0	0	0	0
Net Worth including unres. case res's[7]	(43,442)	(77,980)	(79,885)	(78,715)	(77,075)	(75,242)	(73,371)	(71,106)	(68,507)	(65,555)	(62,237)	(58,525)

Sources: Federal Home Loan Bank Board, press releases in 1988; William C. Ferguson, "Presentation to the Senate Committee on Banking, Housing, and Urban Affairs," May 19, 1988; U. S. General Accounting Office, Financial Audit: Federal Savings and Loan Insurance Corporation's 1987 and 1986 Financial Statements, GAO/AFMD-88-58, July 1988; and M. Danny Wall, "Federal Savings and Loan Insurance Corporation Pro Forma Estimated Budget Outlays and Cash Flows: Fiscal Years 1988 - 1998," prepared for testimony before the Committee on Banking, Finance and Urban Affairs, U. S. House of Representatives, July 7, 1988.

1 Seventy-nine insolvent thrifts were either liquidated or merged with solvent institutions through August 1988, implying a rate of 118 case resolutions per year. This analysis assumes that no additional thrifts become insolvent and no insolvent thrifts return to solvency during 1988 so that 429 of the 508 thrifts which were insolvent under generally accepted accounting principles as of year-end 1987 (see Ferguson (1988)) remained to be liquidated or merged. This analysis assumes that as many as 354 cases are resolved per year starting in 1988.

2 This figure includes the following: A charge of one twelfth of one percent for deposit insurance premiums and one eighth of one percent for special assessments are assessed on average projected deposits; Assets of solvent thrifts are projected to grow seven percent per year, in line with Wall (1988), and assets of insolvent thrifts are assumed to grow at the 1987 rate of 1.9% per year, as per Ferguson (1988); The ratio of deposits to assets is assumed to remain at the year-end 1987 level for solvent and insolvent thrifts, as per Ferguson (1988); Interest on securities is taken from Wall (1988); Interest on advances is projected to grow from the 1986-87 average in proportion to projected deposits; Interest is based on $1,114.2 million of loans to institutions amortized from 1988 to 1995, as per GAO (1988); "Other income" is projected to drop from the 1987 level in proportion to the projected number of unresolved thrift cases.

3 Includes operating expenses and interest on notes payable as projected in Wall (1988), and also includes the net present value projected cost of resolving thrift cases within the year based on the loss rate of 49.7 cents per dollar of asset estimated by the FSLIC for the case resolutions through August 1988 and based on the seven percent net income loss rate for insolvent thrifts in 1987, as reported in Ferguson (1988).

4 Reserves are calculated as the net present value cost of resolving the remaining insolvent thrift cases based on the 49.7 percent average net present cost rate through August 1988 (FHLBB (1988)) and on the seven percent 1987 net income loss rate for insolvent thrifts (according to Ferguson (1988)). Provisions are equal to the addition to end-of-year reserves.

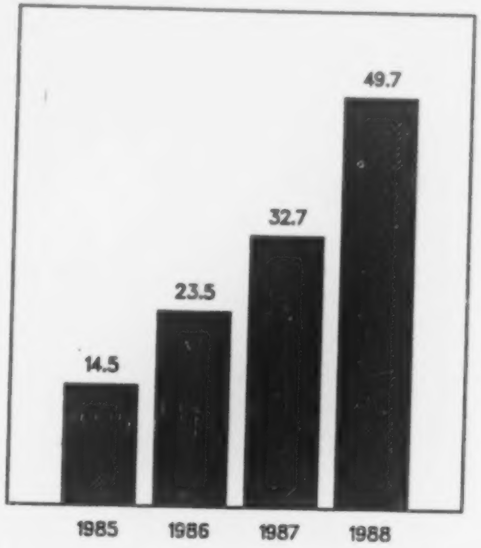
5 Assets are projected to grow in proportion to projected thrift industry deposits.

6 Liabilities excluding unresolved case reolutions are calculated as projected assets minus net worth and unresolved cases reserves.

7 Net worth including unresolved case reserves is calculated as end-of-prior-year net worth plus the year's net income.

FIGURE 1

PRESENT VALUE OF THE NET COST OF RESOLVING FAILED THRIFT INSTITUTION CASES AS A PERCENT OF ASSETS



DATA FROM FEDERAL SAVINGS & LOAN INSURANCE CORPORATION

FIGURE 2

PROJECTED NEGATIVE NET WORTH OF FSLIC EXCLUDING RESERVES FOR UNRESOLVED CASES

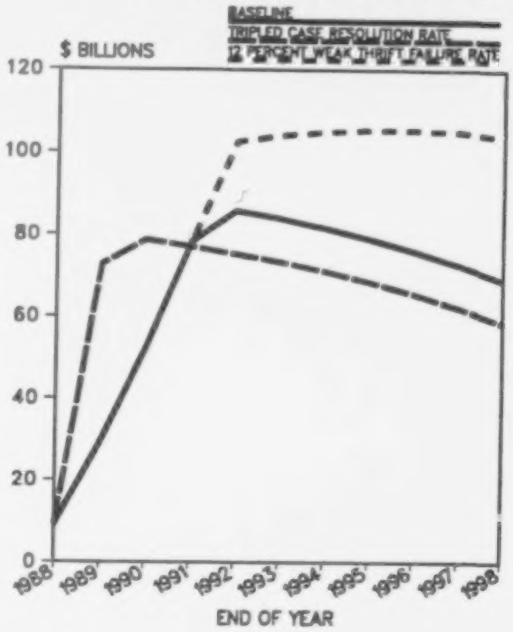
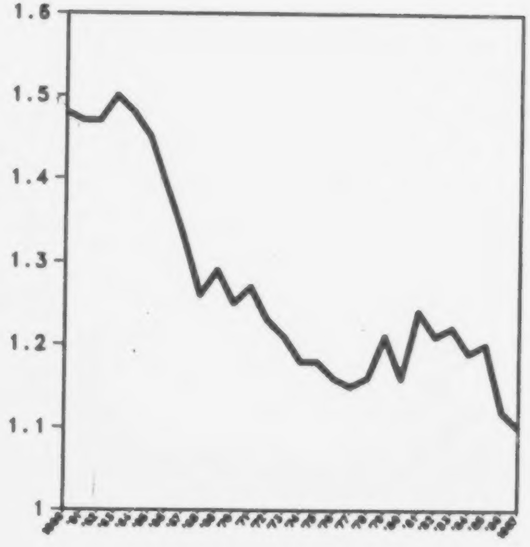


FIGURE 3

Federal Deposit Insurance Corporation Fund
as a Percent of Insured Deposits
December 1960 – December 1987



Data from the Federal Deposit Insurance Corporation.

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Savings and Loan Association Regulatory Reform:
Action Recommendations and Historical Perspective

A report by

The FSLIC Oversight Committee
of the
American Bankers Association

This paper has been prepared as part of the program of study and analysis being conducted by the FSLIC Oversight Committee of the American Bankers Association on the insolvency of the Federal Savings and Loan Insurance Corporation (FSLIC).

Savings and Loan Association Regulatory Reform:
Action Recommendations and Historical Perspective

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Savings and Loan Association Regulatory Reform

Action Recommendations

In its initial report in September 1988 entitled The FSLIC Crisis: Principles and Issues. A Call to Action, the FSLIC Oversight Committee of the American Bankers Association set forth a three-phase action plan to resolve the crisis in the savings and loan association (S&L) industry. Immediate actions called for a halt to the growth of insolvent and nearly-insolvent FSLIC-insured institutions. Near-term actions called for documentation of regulatory, supervisory and accounting deficiencies in the S&L industry, and development of a framework for increasing the pace of bankrupt S&L case resolutions. Longer-term actions called for the 101st Congress to enact legislation to bring S&L industry regulatory, supervisory, and accounting standards up to banking industry levels, require a substantial increase in the pace of insolvent S&L liquidations, and provide a sound means for funding the case resolution process.

This paper focuses specifically on reforms in S&L regulation and supervision. While steps have been taken by the Federal Home Loan Bank Board (FHLBB) to improve the regulation, supervision, examination, and accounting procedures of FSLIC-insured S&Ls, they must be viewed against the backdrop of weak supervision and regulation for more than two decades. To ensure that the crisis does not recur, there must be a commitment to adequate capitalization of FSLIC-insured institutions and effective supervision by Congress, S&L regulators, and the S&L industry. To help ensure that reforms which have been made and those yet to be made are enduring, clear review and accountability procedures must be established. The public and Congress must be informed periodically and systematically about the progress being made for full implementation of corrective actions.

Upon review of a number of specific failures in S&L regulation, supervision, examination, enforcement, and accounting standards, the American Bankers Association offers the following recommendations:

- **The statutory mandate of the FHLBB should be revised so that its regulatory role is focused solely on ensuring the safe and sound operation of the institutions under its jurisdiction.** Any statutory language promoting housing should be confined to the advance program of the Federal Home Loan Bank System.

- **Accountability for effective regulation and supervision of FSLIC-insured institutions should be established.**

  - The FHLBB should publish and annually update a detailed three-year plan for strengthening its regulation and supervision.

  - The Federal Financial Institutions Examinations Council should establish quality-control standards and review mechanisms.

  - Congress should annually hold oversight hearings on the appropriateness of the FHLBB's plans and how well the FHLBB has met its goals.

  - The U. S. General Accounting Office should continue to test for compliance with statutory requirements, and good management and accounting standards.

- Supervision and examination of FSLIC-insured institutions should be integrated.

- Capital standards no less rigorous than those applied to commercial banks should be adopted immediately. Supervisory agreements setting specific targets for improvement of net worth positions and imposing restrictions on bonuses, certain expenses, dividends, borrowings, and rates paid on deposits should be used for those FSLIC-insured institutions unable to meet bank capital standards. Additional enforcement actions should be used to ensure compliance with these agreements.

- Congress should direct the FHLBB to eliminate any remaining elements of Regulatory Accounting Principles. Such action will prevent overstatement of net worth positions under the current five-year phase out of such elements.

- The statutory provision establishing a liquidity requirement for FSLIC-insured institutions should be eliminated and replaced by a provision establishing a net liquidity measure as required for FDIC-insured institutions. The existing statutory requirement, which compares liquid assets to total deposits and short-term borrowings, is misleading. A liquidity requirement should be based upon net liquidity in which certain types of short-term deposits and liabilities are subtracted from liquid assets.

- FSLIC-insured institutions should be subject to the same statutory limitations on loans to one borrower and concentrations of credit as those imposed by bank regulatory agencies on banks.

- The FHLBB should adopt the same policies and procedures as those of bank regulators in closing institutions that become insolvent.

- The FHLBB should adopt the same approach and standards as the bank regulatory agencies in considering incorporations of new institutions and changes in control.

Savings and Loan Association Regulatory Reform

An Overview

The FHLBB has recently begun to take some positive steps toward more effective regulation and supervision. In particular, the FHLBB has brought S&L net worth requirements closer to bank capital standards, improved examiner training, increased the number of examiners, and streamlined procedures for enforcement actions.

Congress has also initiated many improvements. In response to the Competitive Equality Banking Act of 1987 (CEBA), the FHLBB adopted appraisal standards and asset classification systems consistent with those of federal bank regulatory agencies, and has taken steps to phase in over a five-year period generally accepted accounting principles for FSLIC-insured institutions.

Unfortunately, the effectiveness of these recent actions continues to be undermined by the existence of hundreds of insolvent, yet operating FSLIC-insured institutions. Regulatory and supervisory reforms can only be effective when combined with a strong and swift closure policy. Without it, bankrupt and thinly-capitalized S&Ls will have the incentive to continue high-risk strategies. In addition, the ability to regulate healthy S&Ls will be undermined as these institutions will see little value in abiding by costly regulations that do not apply equally to all institutions.

Combined with an effective closure policy, the recent actions have promise. As the action recommendations presented in section I indicate, however, much more needs to be done. Perhaps the greatest obstacle that must be overcome is the perception that the FHLBB lacks the will to discard past practices and move decisively in promoting and implementing new policies and actions. A review of past practices creates deep concerns about the ease with which this obstacle can be overcome.

The failure of regulation and supervision is nowhere more evident than in the deterioration of net worth positions of FSLIC-insured institutions during the 1970s and early 1980s. During this time, net worth requirements in the S&L industry were effectively dismantled. Until 1971, FSLIC-insured institutions were required to have net worth equal to five percent of year-end deposits. The FHLBB substantially weakened this requirement and encouraged rapid deposit growth by allowing net worth to be calculated relative to the average of year-end deposits over the previous five years. In 1980, Congress gave the FHLBB power to vary the net worth requirement between three percent and six percent. While retaining the five-year averaging procedure, the FHLBB quickly moved to reduce the requirement to four percent in October 1980 and to three percent in December 1981. Most S&Ls were thus relieved from any constraint of net worth requirements on deposit and asset growth for at least several years. It was an open invitation for reckless expansion.

Financial soundness was further diminished by other deficiencies in regulation such as the degree of "forbearance" extended to FSLIC-insured institutions with net worth positions well below the minimum requirement, inadequate and misleading liquidity requirements; high loan-to-deposit ratios, high loan-to-value ratios, and overstated property appraisals.

Besides the weaknesses of financial soundness regulation, there were serious deficiencies in the supervision and examination of FSLIC-insured institutions during the early 1980s. The fact is that an adequate and appropriate regime for supervision and examination of S&Ls did not exist at the beginning of the 1980s.

The root of the problem is that the charter of the FHLBB and FSLIC, drafted in the early 1930s, deliberately maintained supervision and examination as separate and distinct activities within the Federal Home Loan Bank System. Supervision of FSLIC-insured institutions was the responsibility of Federal Home Loan Banks (FHL Banks) while examinations were controlled and administered by the FHLBB in Washington, D.C. This separation limited the power of examiners, created delays and indecisiveness, and allowed many troubled institutions to continue business as usual.

The problem was exacerbated by the limited scope of examinations, which emphasized discovery of technical violations of laws and regulations rather than loan quality and the reasonableness of appraisals. The limited scope was in part a result of inadequate staffing and training of field examiners.

Effective supervision and regulation were also constrained by conflicting objectives resulting from the statutory mandate of the FHLBB and district Banks to promote homeownership through home financing. This mandate also made supervision and examination of S&Ls too accessible to interference from the industry and its political allies.

Impeded by these structural and organizational weaknesses, little use was made of enforcement actions such as supervisory agreements, cease and desist orders, and civil money penalties. The rare use was, in part, an outgrowth of misguided FHLBB leadership in the early 1980s which apparently believed that the industry needed less, not more, supervision.

Perhaps the most obvious attempts to paper over the developing problems in the S&L industry were the concessions in accounting standards made in 1980 and 1981. These concessions -- including issuance of income capital certificates, deferral and amortization of losses on sales, special treatment of merger and acquisition premiums to allow long-term amortization of goodwill, and adjustment of net worth to reflect increases in appraised values of premises and related real estate -- enabled FSLIC-insured institutions to show a higher net worth than would otherwise have been the case.

While these accounting concessions were intended to allow S&Ls to "buy time" to "get back on their feet" after the 1979-1981 upswing in interest rates, for some institutions the reprieve served no purpose but to disguise their insolvency which would have been obvious under appropriate accounting standards. Since these insolvent S&Ls were allowed to continue in operation, the accounting reprieve served mainly to allow the launching of speculative expansion plans.

In summary, the dismantling of net worth requirements and other regulatory deficiencies had serious adverse effects on the financial soundness of hundreds of FSLIC-insured institutions throughout the 1970s and early 1980s. Supervision and examination, long burdened by statutory provisions limiting their effectiveness, were grossly inadequate to respond to the challenges facing the S&L industry in the early 1980s. The regulatory authorities turned away from enforcement actions at the very time that their use might have done the most good. Through forbearance policies and accounting concessions, failed and failing institutions were allowed time to compound the extent of their insolvencies. Lack of a meaningful policy to close bankrupt S&Ls only increased the ultimate cost of resolving the problem.

Against this institutional history it is reasonable to express concern whether effective regulation and supervision will really be enduring in the S&L industry. There is a clear need for continuing interest in and close monitoring of improvements. It is in response to that need that the recommendations by the American Bankers Association are made.

Savings and Loan Association Regulatory Reform

Findings of the ABA's FSLIC Oversight Committee: A History of Weak and Permissive Regulatory Oversight

One conclusion reached by the FSLIC Oversight Committee in its September 1988 report was that the FSLIC's insolvency was largely the result of deficiencies in the regulation and supervision of S&Ls. Since early 1987, recognition of deficiencies prompted the FHLBB to initiate a number of changes to improve the regulation, supervision, examination, and accounting practices of FSLIC-insured institutions. In the CEBA, Congress also sought to remedy certain weaknesses. The primary actions are listed below:

- Net worth regulation has been strengthened. In a regulation first issued in January 1985 and substantially revised in August 1986, the FHLBB set a general net worth requirement equal to six percent of assets, with certain phase-in arrangements for low net worth S&Ls. CEBA authorized the FHLBB to establish case-by-case net worth requirements for individual institutions and required the FHLBB, over time, to bring capital requirements for FSLIC-insured institutions into conformity with capital requirements for FDIC-insured banks. The FHLBB has released for public comment an "asset-based," or "risk-based," approach to capital requirements.

- CEBA required that the FHLBB adopt appraisal standards consistent with those of the federal bank regulatory agencies. A regulation implementing that requirement was finalized in December 1987.

- Classification standards and procedures for evaluation of loans and other assets by examiners adopted in December 1985 provoked considerable controversy, but CEBA strengthened the hand of the FHLBB, Federal Home Loan Banks, and examiners by requiring adoption of a classification of assets system consistent with that of the federal bank regulatory agencies. The regulation was adopted in December 1987.

- The FHLBB has taken several steps to bring direct investments under close supervision and control. The approach has been to impose the same diversification standards on direct investments as on loans.

- The FHLBB has sought to streamline procedures for taking formal supervisory actions and to make clear to the managements of all FSLIC-insured institutions the circumstances under which such actions will be taken.

- The number of persons employed in examination and supervision has been substantially increased, salaries have been increased, and new emphasis is being placed on training.

While constructive, these changes must be viewed against a long history of weak regulatory and supervisory practices by the FHLBB and FSLIC. The deficiencies leading to S&L failures and the FSLIC's bankruptcy were not lapses from standards that had previously been adequate. In fact, numerous compromises and concessions were made in regulatory, supervisory, and accounting standards for FSLIC-insured institutions during the 1960s and 1970s. While these compromises were usually rationalized as necessary to meet the "housing mandate" of the S&L industry, they had serious adverse effects on the soundness of many S&Ls and the integrity of the supervisory framework.

The recent changes must also be viewed against the hundreds of insolvent FSLIC-insured institutions that continue to operate. Changes in regulation and supervision have served little or no value in altering incentives of bankrupt and thinly-capitalized S&Ls to pursue high-risk strategies. Only rapid closure of bankrupt S&Ls would serve this purpose.

To understand the significance of these changes and demonstrate the need for close monitoring to ensure that they are effective and enduring, it is important to review past deficiencies in S&L financial soundness regulation, supervision and examination, enforcement action usage, and accounting standards.

Financial Soundness

Regulation and supervision are dedicated to ensuring that financial institutions act in accordance with safe and sound practices. The experience of S&L regulation and supervision suggests that serious lapses occurred in carrying out this responsibility. On the regulatory side, this failure was evident in setting and administering net worth requirements, capital forbearance policies, and liquidity requirements. The differences in financial soundness standards between FDIC-insured commercial banks and FSLIC-insured S&Ls help explain why S&Ls were more vulnerable to failure in the 1980s. The following summarizes the differences:

- Lower capital/net worth requirements meant that FSLIC-insured S&Ls had relatively smaller amounts of net assets, or solvency "cushions," to cover loan and operating losses than FDIC-insured banks.

- Greater "forbearance" allowed a large number of S&Ls to fall deeper and deeper into negative net worth positions, compounding the FSLIC's losses.

- Higher loan-to-deposit ratios allowed FSLIC-insured S&Ls to take on significantly greater risk exposure than FDIC-insured banks.

- Higher limits on loans to one borrower for FSLIC-insured S&Ls than for FDIC-insured banks helped foster concentrations of speculative loans.

Dismantling of Net Worth Requirements

The legacy of compromises and concessions made in the two decades before 1980 is nowhere more evident than in the widespread weakness in net worth positions of FSLIC-insured institutions that developed during the 1970s and led to widespread failures in the 1980s.

When Congress delegated broad authority to the FHLBB to charter and regulate federal savings and loan associations in Section 5 of the Home Owners Loan Act of 1933, no mention was made of any kind of net worth or capital adequacy requirement as we know it today. Such an omission was inherent in the structure of savings and loan associations at that time. Savings accounts in an association were shares, not deposits. In fact, Section 5(b) of the 1933 Act barred the taking of deposits. The savings, or share, accounts were the capital of a savings and loan association, and account holders had the status of shareholders, not depositors. The amount by which total assets of an association exceeded total liabilities and share accounts was denoted as "surplus" or "reserves" (for loan losses).

The Housing Act of 1934, which established the FSLIC, provided for insured savings and loan associations to accumulate and maintain a "Federal Insurance Reserve" (FIR) equal to five percent of total share accounts. The Act established a phase-in period of ten years for newly chartered institutions; because federal chartering had been initiated only in 1933, a large number of institutions qualified for the phase-in period. Several years later the statute was amended to extend the phase-in period to twenty years. The net worth requirements for FSLIC-insured institutions today are descendants of the FIR requirement enacted in 1934.

The Housing Act of 1968 deleted the restriction in the Home Owners Loan Act of 1933 that barred federally-chartered S&Ls from accepting deposits. Similar legislative changes had been made in various states, beginning in the late 1950s. Shareholders became depositors (creditors), and what had been the capital of savings and loan associations became liabilities (deposits). This was a fundamental change in financial structure. It clearly required, at a minimum, significant strengthening of the FIR, or net worth, requirement and preferably the articulation of a whole new standard of capital adequacy.

The FHLBB did make an attempt in 1972 to strengthen enforcement of the FIR requirement and to impose supplemental net worth requirements based on an institution's risk exposure. The S&L industry not only beat back this attempt at tighter regulation by the FHLBB, but obtained new concessions by appealing to Congress. The FIR phase-in period was extended from twenty to twenty-five years by Congress, and even more importantly, the FHLBB issued a new regulation permitting S&Ls to average year-end deposit balances over the past five years to compute the statutory net worth requirement for the current year.

The S&L industry went back to Congress in 1979 to ask for a reduction in the statutory net worth requirement from five to four percent. The FHLBB went even further and requested of Congress authority to vary the requirement between three and six percent. Such authority was granted in the Depository Institutions Deregulation and Monetary Control Act of 1980 and the FHLBB proceeded to reduce the statutory net worth requirement to four percent in October 1980 and to three percent in December 1981.

The dismantling of net worth requirements during the 1972-1982 period was the single most important factor contributing to the wave of S&L failures after 1982. The "five-year averaging" regulation should probably be regarded as the single most disastrous move ever made by a regulatory agency with respect to capital adequacy. Combined with the three percent net worth standard established in December 1981, it provided a powerful incentive for aggressive expansion.

To illustrate this point, suppose that an S&L had a five-year growth pattern as shown in the example in Table 1. By the end of 1981, its net worth requirement would have been $3.60 million or 2.6 percent of year-end 1981 deposits. Expansion of deposits by fifty percent over the next year would have increased the dollar amount of the net worth requirement to $4.26 million, dropping the ratio of required net worth to year-end deposits to 2.0 percent. On the 1982 increase of $70,000,000 in deposits, the incremental net worth requirement would have been $660,000 -- only 92 basis points.

Without meaningful restraints, growth of deposits and assets of FSLIC-insured institutions surged in 1982-1984. By early 1984, the FHLBB proposed changes in net worth requirements aimed at slowing the rapid pace of S&L expansion, including elimination of the five-year averaging method. But industry opposition again prevailed and the proposal was suppressed. It was not until January 1985 that the deteriorating condition of large numbers of S&Ls and the dwindling resources of the FSLIC caused sufficient concern within the industry to support an upward revision in net worth requirements.

In August 1986, the FHLBB set forth a "three step" approach to determination of net worth requirements:

1) A basic "liability component" required a thrift institution to have net worth equal to six percent of liabilities. Growth in liabilities had to be supported immediately at six percent. A phase-in process was provided for institutions unable to meet the six percent requirement on existing liabilities.

2) A "contingency component" increased the net worth requirement by specific percentages according to designated types of risky and scheduled assets.

3) A "maturity matching credit component" allowed institutions to reduce net worth requirements below six percent by having one-year and three-year hedged maturity gaps in selected ranges. By keeping such gaps below fifteen percent absolute value, an institution could reduce its net worth requirement to as low as three percent of liabilities through August 1989, and to four percent thereafter.

CEBA authorized the FHLBB to modify net worth requirements for individual institutions as necessary in the light of circumstances affecting that institution. The promulgation of the law by the FHLBB occurred in December 1987. With minor changes, the "three step" calculation established in August 1986 continued in effect.

The foregoing review of changes in net worth requirements for FSLIC-insured S&Ls is a disturbing story. Congress and the FHLBB, responding to pressures from the S&L industry, systematically and decisively dismantled net worth requirements between 1972 and 1982. By the time an attempt was made to restore some semblance of effective requirements in January 1985, insolvency was already epidemic.

Excessive Capital Forbearance

Another dimension of the problem of inappropriate regulation of net worth positions has been the degree of "forbearance" extended in 1982 and 1983 to FSLIC-insured institutions with net worth positions below the minimum requirement. Since its inception in 1934, the FSLIC has had broader discretionary authority than the FDIC to assist troubled institutions. Though the FDIC's discretionary authority has recently been expanded, the FSLIC still appears to have more flexibility.[1]

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[1] The broad authority of the FSLIC is a vestige of the structure of savings and loan associations at the time of passage of the Housing Act of 1934. As discussed above, savings accounts were not deposits but were the "share capital" of savings and loan associations. The inability of an association to honor a request for withdrawal of funds from a savings account did not constitute default. The owner of the savings account, or "share capital," could be required to wait until the association had funds in hand to honor the withdrawal request. Under FSLIC policy and practice, "default" did not occur until an association was placed in receivership. The conferring of deposit status on

(Footnote Continued)

The forbearance actions of the early 1980s are summarized in the following quotation from *Where Deregulation Went Wrong*, written by Norman Strunk and Fred E. Case and published by the U. S. League of Savings Institutions in 1988:

> The response of the business [S&L industry] to its net worth problems in 1982 and 1983 was to ask, in addition to lowering of the net worth requirements to three percent, for forbearance on enforcing even that low benchmark, and net worth assistance in the form of income capital certificates first provided by administrative action of the Board, and later by the Garn-St Germain Act.
>
> The Board responded with a variety of ameliorating provisions. These included the creation of goodwill assets from supervisory-induced mergers, which initially could be amortized up to 40 years [now 25 years], appraised equity capital from revaluing the business' fixed assets; and a new regulation permitting the deferral of losses on loan sales.[2]

Under the net worth certificate program, assistance was available to institutions with net worth as low as 0.5 percent of assets, *based on Regulatory Accounting Principles (RAP)*. On the basis of generally accepted accounting principles (GAAP), many of these S&Ls would have had negative net worth. Moreover, on a tangible net worth basis, which is closer than GAAP to the accounting principles used in determining the net worth of commercial banks, a significant number of FSLIC-insured institutions were insolvent by late 1982 or early 1983 (see Graph 1). Thus, extensive use of forbearance for institutions that were barely solvent on the most lenient accounting basis acted only to delay resolution of problem cases, ultimately at a much greater cost.

Capital standards no less rigorous than those applied to commercial banks should be adopted immediately for S&Ls. Supervisory agreements setting specific targets for improvement of net worth positions and imposing restrictions on bonuses, certain expenses, dividends, borrowings, and rates paid on deposits should be used for those S&Ls unable to meet bank capital standards. Additional enforcement actions should be used to ensure compliance with these agreements.

Misleading Liquidity Requirements

Misleading liquidity requirements were another aspect of regulatory policy affecting the financial soundness of FSLIC-insured institutions. In this case, inappropriate regulatory policy in the 1980s was not reflected so much in reductions in liquidity requirements as in policy changes that allowed S&Ls to increase their reliance on short-term borrowings without reflecting this trend in measures of liquidity.

The FHLBB was given authority in 1950 to set liquidity requirements in a range between four and eight percent of an S&L's savings deposits. Cash, deposits at FHL Banks, and U. S. Treasury securities were designated as eligible assets for the liquidity requirement. Subsequent statutory changes broadened the range from four to ten percent; expanded the types of eligible assets to include bank deposits, federal agency issues, and certain state and local government obligations; and expanded the base for calculation of the requirement to include total deposits plus short-term borrowings.

Since the early 1980s, borrowings by FSLIC-insured institutions -- from FHL Banks and other financial institutions -- have increased more rapidly than their holdings of liquid assets. At the end of 1987, borrowings exceeded liquid assets for the industry as a whole. This "negative gap" would be even wider if large certificates of deposits were counted as borrowings.

Thus, the *net* liquidity of the industry was negative even though liquid assets were in excess of ten percent of total of deposits and short-term borrowings. Meeting the existing requirement gives the impression that an institution's liquidity is adequate when in fact the institution may owe more in short-term borrowings than it has in liquid assets. In reality, the liquidity of FSLIC-insured institutions today is almost totally dependent on the FHL Banks.

The statutory provision establishing a liquidity requirement for FSLIC-insured institutions should be eliminated and replaced by a provision establishing a net liquidity measure in which certain types of short-term deposits and liabilities are subtracted from liquid assets.

Inadequate Limits on Loans to One Borrower

National banks are allowed to make unsecured loans to one borrower up to fifteen percent, and well-secured loans up to twenty-five percent, of the bank's capital and surplus. An S&L, on the other hand, can loan 100 percent of its net worth to any borrower. This has led to loan concentrations in many S&Ls, increasing the risk to the institution. Moreover, this risks was exacerbated in many S&Ls due to the highly speculative nature of many of these loans.

The FHLBB has recognized that excessive loans to one borrower have contributed to major losses at and eventual failure of a number of S&Ls. While the FHLBB has considered making S&L loan limits consistent with bank limits, no final action has been taken. In view of the credit loss experience of so many floundering S&Ls, adoption of bank loan limits, together with the same vigorous enforcement facing banks, is needed.

Inadequate limits were also reflected in high loan-to-deposit ratios permitted of FSLIC-insured institutions. In the early 1980s the FHLBB encouraged S&Ls to expand loans and accept higher loan-to-deposit ratios (sometimes in excess of one hundred percent). High loan-deposit ratios may have been acceptable when the savings accounts were "share capital" and could be regarded as relatively long-term placements of funds by individuals and households. However, the interests of safety and soundness of the financial system would have been better served by lower loan-deposit ratios when savings accounts became deposits and rate competition for deposit funds intensified. Clearly, lower loan-to-deposit standards, appropriate to modern deposit liquidity, should be established.

(Footnote Continued)
such savings accounts, as effected at the state level beginning in 1958 and at the federal level in 1968, obligated institutions to honor withdrawal requests when made but did not alter the FSLIC's policy and practice that an institution was not in default until placed in receivership. The FSLIC thus assumed a very large burden to protect depositors in insured S&Ls.

[2] Strunk, Norman and Fred Case. *Where Deregulation Went Wrong: A Look at the Causes Behind Savings and Loan Failures in the 1980's.* United States League of Savings Institutions, 1988, Page 37.

Supervision and Examination

In addition to failures of regulation which led to a deterioration of financial soundness in FSLIC-insured institutions, there was also a failure in the supervision and examination process:

- Separation of supervision and examination in the Federal Home Loan Bank System (FHLB System) was a serious impediment to effectiveness in supervision and examination.
- Supervision was afflicted by delays and indecisiveness.
- Examinations, even after their scope was broadened in the latter 1960s, continued to be more oriented to detection of violations of laws and regulations than to the quality of assets and the soundness of institutions.
- The examination function in the FHLB System was understaffed, underpaid, and under-trained.
- As a result of the promotional aspects of the FHLBB's "housing mandate," supervision and examination of S&Ls have been too often constrained by conflicting objectives and have been too accessible to interference from the industry and its political allies.
- The shift of the examination staff from the FHLBB to the FHL Banks was an expedient dictated by unreasonable and unrealistic restrictions imposed by the Office of Management and Budget. While the move was beneficial and necessary, a conflict of interest may still prevail since the Boards of Directors of the FHL Banks are composed primarily of officers of insured thrift institutions in the respective districts.

Mistaken Separation of Supervision and Examination

Until July 6, 1985, federal supervision and examination of FSLIC-insured institutions were deliberately maintained as separate and distinct activities. On one hand, supervision was the responsibility of the district FHL Banks. Each of the twelve district Bank presidents is, by statute, the "Principal Supervisory Agent" in his district. Considerable power and authority for supervision of insured S&Ls are thus held by each president. Potential conflicts may arise since the president of each district Bank is elected by the Bank's board of directors, a majority of which are officers of insured S&Ls in that district.

On the other hand, examination of FSLIC-insured institutions (prior to July 6, 1985) was controlled and administered by the FHLBB staff in Washington, D.C. under a Director of Examinations and Supervision appointed by the FHLBB. The 1980 Annual Report of the FHLBB described the separation of the operations of the Office of Examinations and Supervision (OES) from the examinations staff as follows:

> Through a field staff of approximately 900 examiners and support staff, OES conducts on site examinations of [insured] institutions to determine their financial safety and soundness and their compliance with federal statutes and Bank Board regulations. OES's Washington-based Supervision staff reviews reports of these examinations to determine the necessity of corrective supervisory action in coordination with supervisory agents in the 12 Federal Home Loan Banks, the FSLIC staff, and, as necessary, counterpart state regulatory agencies in the case of state-chartered institutions.[3] [Emphasis added]

The deliberate separation of supervision from examination in the FHLB System was encouraged by the S&L industry. Strunk and Case, in the work cited above, state that in the 1930s the U. S. Building and Loan League (grandfather of the current-day U. S. League of Savings Institutions) did not want S&L examiners to have as much power as bank examiners because "many banks closed by [bank] examiners should not have been closed."[4] Further:

> For generations the savings and loan business has been wary of examiners and supervisors. The business has tried to keep examination costs and supervision to a minimum, possibly because its early leadership distrusted the whole supervisory process.[5]

The U. S. Building and Loan League believed that:

> Too much discretion had been given the field examiners to decide the quality of bank assets and hence their solvency. In contrast to the bank supervisory apparatus, this led to the separation of the examination and supervisory functions in the organization of the Bank Board and a detailed regulatory system for the savings and loan business which was not fundamentally altered until 1986.[6]

The reference to "detailed regulatory system" is significant. It means that: 1) the federal and state rules and restrictions affecting FSLIC-insured institutions should be specifically set forth in laws and regulations; 2) that examiners should test only for compliance with the rules and restrictions set forth in laws and regulations; and 3) that the managements of FSLIC-insured institutions should be allowed to conduct their business as they pleased so long as they are in technical compliance with the specific provisions of applicable laws and regulations. This was the view that dominated supervision and examination in the FHLB System until the mid-1980s and may still dominate industry views about supervision and examination.

Supervision and examination of FSLIC-insured institutions should be coordinated and integrated; recognition of problems should be closely linked to remedial actions.

Conflicting Mandate to Promote Yet Regulate

In addition to the separation of supervision from examination and close containment of discretionary authority, supervision and examination in the FHLB System were constrained by the System's "statutory mandate" to promote homeownership through home financing. The FHLBB apparently interpreted that "mandate" as an obligation to be the S&L industry's advocate with Congress and the public.

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[3] Federal Home Loan Bank Board, Annual Report, 1980, page 39.

[4] Ibid., page 18.

[5] Ibid., page 114.

[6] Ibid., page 18.

The statutory mandate of the FHLBB should be revised so that its regulatory role is focused solely on ensuring the safe and sound operation of the institutions under its jurisdiction. Any statutory language promoting housing should be confined to the advance program of the FHLB System.

Limited Scope of Examinations

Until the late 1970s, examinations of FSLIC-insured institutions were directed more to discovery of violations of laws and regulations than to evaluation of the quality of loans and investments, and the institution's safety and soundness. In fact, it was not until the late 1960s that the scope of examinations included regular reviews of loan quality and the reasonableness of appraisals. Moreover, the FHLBB was slow in instituting appropriate guidelines for such reviews and developing relevant training programs for examiners. The lack of sophistication in early attempts to conduct reviews of loans and appraisals served to confirm the long standing industry opinion that examiners could not be trusted to make proper evaluations of loan and appraisal activities.

The limited scope of examinations was also reflected in high loan-to-value ratios. High ratios have been a problem in the S&L industry since the first "no, no, no downpayment" home mortgage loans were introduced in California in the 1950s. The problem was exacerbated in the 1980s by overly generous property appraisals. Many recent S&L failures have been attributed to faulty documentation and appraisal standards. Assuming realistic appraisals and borrowers with acceptable credit standings, high loan-to-value ratios can be tolerated in home mortgage lending. However, in lending for real estate development, commercial real estate, and commercial and industrial activities in general, high loan-to-value ratios have long been recognized as involving more than ordinary exposure to default risk. Defaults have left FSLIC-insured institutions now holding over $26 billion of foreclosed real estate.

By the late 1970s, the FHLBB finally began serious training of its examiners to evaluate the financial soundness of insured institutions. Recent improvements in training have also been initiated. In light of the recent real estate problems for S&Ls, the FHLBB must monitor appraisal procedures and loan-to-value ratios more closely for the institutions it oversees.

Delays and Indecisiveness

It is widely acknowledged within the S&L industry that the processes of examination and supervision in the FHLB System have been seriously afflicted by delays and indecisiveness. In an extensive review of the industry in 1969 (sponsored by the FHL Banks), Irwin Friend found that supervisory officials were indecisive in dealing with problem situations and that deliberations, involving FHL Bank staff in a district and FHLBB staff in Washington, took inordinately long periods of time.[7]

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[7] Friend, Irwin, ed., Study of the Savings and Loan Industry, vols. I-IV, Federal Home Loan Bank Board, Washington, D. C. 1969.

A study by the U. S. General Accounting Office (GAO) in 1981[8] also found delays and indecisiveness. "Total processing time from the date of the association's net worth failure to execution of the [supervisory] agreement ranged from five to 29 months for the fifteen agreements which were executed. The average time was 12.5 months." The GAO emphasized: "Indecisiveness contributes to time delays," and proceeded to describe a case in which FHLBB staff in Washington and FHL Bank staff in a district took "20 months to work out differences between themselves and with an insolvent association's management as to the content and form of a supervisory agreement."

Annual reports of the FHLBB during the 1980s indicate concern with a need to "streamline" administrative processes.

Ineffectual Examinations

The field examination staff of the FHLBB included 815 persons in 1976, an increase of only sixty over the 1966 staff. Over the same time period, total assets tripled ($133.8 billion to $390.4 billion), and S&L operations became more complex. Even assuming that the 755 persons in 1966 were sufficient in number to administer and conduct the limited-scope examinations of that time, it would be ludicrous to think that a staff of 815 was adequate to conduct examinations of wider scope in 1976.

A similar pattern was observed between 1976 and 1985. The size of the field examination staff stayed nearly constant (being closely constrained especially after 1978) while the industry assets grew to over $1 trillion (see Graph 2).

FHLBB examiners were transferred from the FHLBB to the FHL Banks on July 6, 1985. The purpose of the move was to escape the constraints on salaries and hiring of the Office of Management and Budget. At that time, 747 of the total field examination staff of 897 were listed as examiners. By the end of October 1987, the number of examiners had been increased to 1,424.

The shift of examiners from the FHLBB to the FHL Banks not only facilitated a much-needed increase in the number of examiners but also a much-needed increase in salary levels. Before the move the entry-level salary of examiners at the FHLBB was $3,360 below the entry-level salary for FDIC examiners, and the average salary of FHLBB examiners was $7,730 below the average salary of examiners at the FDIC. These differentials were quickly eliminated after the transfer of FHLBB examiners to the district banks.

Deficient Incorporation Standards

Lax regulation and supervision of FSLIC-insured institutions had another important consequence: they encouraged incompetent and unscrupulous individuals to either charter a new S&L or take over an existing one. Since current regulations permit an S&L to be organized by only one person, and given the laxity of oversight, individuals were afforded opportunities to use insured deposits in reckless, and in many cases criminal, ways. Recent reports state that fraud and insider abuse were present in 168 of 210 S&L insolvencies since 1984, representing millions of dollars of losses.

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[8] U. S. General Accounting Office. Formal Supervisory Process for Savings and Loan Associations should be Strengthened, September 17, 1981.

Clearly, tighter controls must be established to assure that insured S&Ls are operated by competent persons of high integrity. The FHLBB should adopt the same approach and standards as the bank regulatory agencies in considering changes in control and de novo incorporations.

Infrequent Use of Enforcement Actions

Regulators can use enforcement actions, including removal of officers, to halt unsafe and unsound practices. Once again, this tool was used ineffectively by the FHLBB:

- The use of enforcement actions by the FHLBB was impeded by structural and organizational weaknesses, especially the separation of supervision and examination.
- The use of enforcement actions was suppressed in the late 1970s and early 1980s, reflecting significant opposition from the industry and the distaste of FHLBB members for such actions.
- In the period 1983-1985, the FHLBB was slow in recognizing that enforcement actions could be used effectively to correct many of the problems causing insolvencies.
- Lack of experience in the use of enforcement actions as well as flawed fact-finding and decision-making procedures hampered the effectiveness of the FHLBB when it established an Office of Enforcement and began to try to make more aggressive use of enforcement actions in November 1985.

Several types of enforcement actions are available to the FHLBB, reflecting provisions of the Home Owners Loan Act of 1933, the National Housing Act of 1934, the Financial Institutions Supervisory Act of 1966, and the Financial Institutions Regulatory and Interest Rate Control Act of 1978. The available actions include supervisory agreements, cease and desist orders, civil money penalties, removal of officers, formal investigations, and termination of insurance.

The FHLBB reduced its use of enforcement actions in 1978-1980 and limited use of such actions in the period 1981-1983 (see Table 2). In its 1981 study, Formal Supervisory Process for Savings and Loan Associations Should Be Strengthened, the GAO found that this coincided with an increase in S&Ls on the FHLBB's problem list. The GAO noted that these "problem" institutions presented opportunities for use of enforcement actions. "Although not all institutions on the FHLBB's problem list have problems which can be corrected by initial formal action, our analysis...shows that most institutions on the December 3, 1979 list had problems that can be corrected by formal supervisory actions."[9]

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[9] The GAO found that of the 79 cases then on the FHLBB's problem list, 55 (two thirds) were strictly safety and soundness problems. Of the remaining 28 cases, 25 involved safety and soundness as well as regulatory violations. Of the 122 institutions on the list at January 31, 1981, 70 were new additions. All 70 involved safety and soundness issues, and 59 (or 84 percent) were strictly safety and soundness problems.

The GAO found that 55 (65 percent) of the 85 cases in which formal actions (Footnote Continued)

The use of enforcement actions is often complicated by procedures that must be followed to assure due process and to protect banks and individuals against disclosure of confidential information. Such complications, however, were not the reason for the limited use of enforcement actions by FHLBB during the late 1970s and early 1980s. Three reasons are readily apparent:

- The FHLBB's use of enforcement actions was seriously impeded by bureaucratic delays and indecisiveness;[10]
- The limited scope of examinations, inadequate training of examiners, and separation of examination and supervision were significant barriers to the timely discovery and necessary documentation of problems susceptible to correction through enforcement actions; and
- Misguided FHLBB leadership believed that the industry needed less, not more, supervision.[11]

In general, the use of "informal" actions, i.e., oral and written persuasion, is a preferred method to bring managements into line with applicable laws and regulations or to halt unsafe and unsound practices. Reliance on informal approaches has a long history in the supervision of banks. However, bank examiners have been very much involved in most "informal" actions whereas FHLB System examiners were limited to the role of "fact finders." The effectiveness of "informal" actions in banking has benefitted from the ability of examiners to obtain compliance "on the spot" at the time a violation or unsafe and unsound practice is detected.

Permissive Accounting Standards

Perhaps the most striking example of regulatory attempts to paper over the problems was the use of permissive regulatory accounting standards. This had the important consequence of delaying action on the large and growing number of insolvencies that were painfully obvious under generally accepted accounting principles and on a tangible capital basis. Other consequences are evident as well:

- The net worth of the S&L industry continues to be overstated -- by a relatively significant amount -- due to accounting concessions made by the FHLBB between 1981 and 1982.

(Footnote Continued)
were used (between March 1978 and July 1980) had involved regulatory violations, not financial soundness issues. Regulatory violations and safety and soundness problems were found in twenty cases, and only ten cases involved only safety and soundness problems. Thus, enforcement actions were being used somewhat more to deal with regulatory violations than with safety and soundness problems.

[10] This is well documented in the GAO's 1981 report cited above.

[11] The 1981 Annual Report of the Federal Home Loan Bank Board (page 8) summarized this philosophy succinctly: "The savings and loan industry in the U.S. has been over-regulated. This regulatory zeal was intended to serve two purposes -- one, to assure a supply of relatively low-cost mortgage credit and, two, to preserve the safety of deposits. With hindsight, it appears this approach may have been fundamentally in error, despite the value of the goals being served."

- Although Congress, in CEBA, mandated that S&Ls move to a GAAP accounting basis by December 31, 1987, the FHLBB used provisions designed for specific and exceptional cases to postpone compliance for all FSLIC-insured institutions for one year. Individual institutions can still be exempted until the end of 1993.

- A provision also existed under CEBA which allowed institutions in general to retain net worth elements previously derived from the 1981-1982 concessions.

The FHLBB made several concessions in accounting standards during 1981 and 1982 to permit FSLIC-insured institutions to show higher amounts of net worth than would otherwise have been the case:

- In September 1981, troubled institutions were authorized to issue special securities (income capital certificates) to be purchased by the FSLIC, either with cash or interest-bearing FSLIC notes, and to be included as net worth by the issuing institutions. The passage of the Garn-St Germain Act in October 1982 authorized the FSLIC and FDIC to purchase net worth certificates issued by troubled institutions.

- Also in September 1981, FSLIC-insured institutions were permitted to defer and amortize over a period of years the losses sustained on sales or other dispositions of mortgage loans, mortgage-related securities and debt securities.

- In July 1982, the FHLBB permitted goodwill resulting from the acquisition or merger of an S&L institution to be amortized over a long period (40 years), while the income realized from the difference between the book and market values of assets could be accumulated over a short period (5 to 10 years). The amortization period for acquisition goodwill was later reduced to 25 years.

- In August 1982, the FHLBB authorized insured institutions to include in regulatory net worth any subordinated debentures, redeemable mutual capital certificates, and nonpermanent preferred stock having a remaining term-to-maturity or term-to-redemption exceeding one year.

- In November 1982, FSLIC-insured institutions were permitted to increase their net worth positions on the basis of the appraised values of premises and related real estate.

In 1986, net worth certificates, deferred losses, acquisition goodwill, subordinated debt, and appraised equity capital amounted to $13.4 billion -- equal to 25 percent of the $53 billion of regulatory net worth of S&Ls, and equal to 1.15 percent of their total assets of $1,172 billion.[12] This measures the conceptual difference between "RAP net worth" and "GAAP net worth." Recent estimates from the FHLBB show that as of the end of June 1988, 2,596 "GAAP solvent" institutions had RAP net worth equal to 5.8 percent of assets and GAAP net worth equal to 5.1 percent of total assets. For the 496 "GAAP insolvent" institutions, RAP net worth was -4.8 percent of total assets and GAAP net worth was -8.6 percent of total assets.

The consequence of permissive accounting is painfully clear when the length of insolvency is measured using different accounting principles (see Graph 1).

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[12] R. Dan Brumbaugh, Jr. Thrifts Under Siege, page 45.

On a regulatory accounting basis, only 17 FSLIC-insured institutions reported negative net worth for five years or more.[13] However, on a GAAP basis, over 100 FSLIC-insured institutions had negative net worth for over five years, and on a tangible capital basis -- which is closer than GAAP to the accounting principles used in determining the net worth of commercial banks -- more than 225 S&Ls had negative net worth for over five years.

The accounting concessions made by the FHLBB in 1981 and 1982 were initially aimed at "buying time" for FSLIC-insured institutions to recover from the damage done to their net worth positions by the 1979-1981 upswing in interest rates. However, efforts to buy time in the short run had serious longer-term consequences. This is illustrated clearly in the regulation permitting deferral of losses on loan sales. Strunk and Case make the following observation on this point:

> This regulation had the temporary effect of boosting income because associations could sell lower rate loans and reinvest in more profitable assets. But as it turned out, this provision encouraged associations to dump their low rate and lower valued assets at just the wrong time. Hindsight shows that they could have sold these loans at much higher prices. The amortization of the loss deferral is now a drag on earnings for those who took advantage of this authority.[14]

For many institutions "buying time" was not an appropriate strategy. Changes in the financial environment had made them uneconomic units, regardless of the amount of time they might be given to try to effect recovery. A number of these uneconomic units, seeing that there might be no tomorrow, were the ones that gambled in 1983-1985 on programs of aggressive expansion of high-cost deposits and high-risk loans and investments.

Congress attempted to correct the accounting deficiencies and mandated, in CEBA, that FSLIC-insured institutions use GAAP accounting, effective December 31, 1987. The FHLBB, however used a provision in the Act designed to exempt individual S&Ls from compliance in special circumstances up to year-end 1993 to delay implementation for all FSLIC-insured institutions for one year. This action was disturbing in that it demonstrated the lack of commitment on the part of the FHLBB to correct past mistakes.

The rule promulgated by the FHLBB retained some RAP elements until January 1, 1994. More specifically, RAP may continue to be used in preparing unaudited regulatory financial statements beginning on or after January 1, 1989, for the following:

- Deferred loan losses: These may continue to be reported through December 31, 1993. Beginning January 1, 1994, such losses and gains are not allowed.

- Mutual funds: Investments in liquid asset mutual funds may be reported at cost through December 31, 1993. Beginning January 1, 1994, mutual funds must be reported in accordance with GAAP (SFAS 12).

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[13] Barth, James R. and Bradley, Michael G., "Thrift Deregulation and Federal Deposit Insurance," Office of Policy and Economic Research, Federal Home Loan Bank Board, 1987. The length of insolvency is calculated for those GAAP-insolvent FSLIC-insured institutions as of June 1988.

[14] Strunk and Case, Ibid, pages 37-8.

- Consolidated reporting: Financial statements may continue to be reported on an unconsolidated basis through December 31, 1989. Beginning January 1, 1990, consolidated reporting is required.

Thus, the FHLBB regulations not only delayed the effective date by one year, they also allowed the three RAP exceptions and a phase-in period not authorized by CEBA.

In light of the history of weak and permissive regulatory oversight of S&Ls, a system must be devised to ensure that those individuals who are responsible to regulate and supervise these institutions are held accountable for their actions. As part of a system of accountabilities, the FHLBB should publish and annually update a detailed three-year plan for strengthening its regulation and supervision; the Federal Financial Institutions Examinations Council should establish quality-control standards and review mechanisms; Congress should annually hold oversight hearings on the appropriateness of the FHLBB's plans and how well the FHLBB has met its goals; and the U.S. General Accounting Office should continue to test for compliance with statutory requirements, and good management and accounting standards.

The Lack of a Closure Policy

A pervasive theme underlying the regulatory and supervisory decisions reviewed in this paper was to keep insolvent and nearly-insolvent FSLIC-insured institutions in operation in the hopes that someday they would regain their viability. While there may be unusual circumstances that would lead to forestalling the closure of a particular institution, the FHLBB took the position in all aspects of its regulation and supervision that problem S&Ls should be saved.

As is now painfully obvious, this policy was dangerously shortsighted and served only to increase the ultimate cost of resolving the hundreds of insolvent FSLIC-insured institutions. In fact, of all the regulatory and supervisory failures, the lack of an adequate closure policy may be the biggest contributing factor to the huge losses that currently face the FSLIC. Regardless of the mix of assets in an S&L's portfolio, closing an institution at the point where capital is exhausted would minimize losses to the insurer. This may well explain why the FSLIC's losses have been enormous compared to losses at the FDIC. The FHLBB should adopt the same policies and procedures as those of the bank regulators in closing institutions that become insolvent.

No complicated early warning system was needed to see the problems that were developing. High rates of growth and high interest rates paid on deposits were clear signs to S&L regulators that concern was warranted. But weak regulatory, supervisory, and accounting standards allowed insolvent S&Ls to continue to operate and continue to make risky, uneconomic investments.

Table 1

Example of the Impact of the Five-Year Deposit Averaging Scheme on Net Worth

Year	Deposits	5-year Deposit Average	Net Worth Requirement	Net Worth as a percent of year-end Deposits	Increase in Net Worth as a Percent of the Change in Deposits
	($ Millions)				
1977	$100				
1978	110				
1979	120				
1980	130				
1981	140	$120	$3.60	2.6	
1982	210	142	4.26	2.0	.92

Table 2

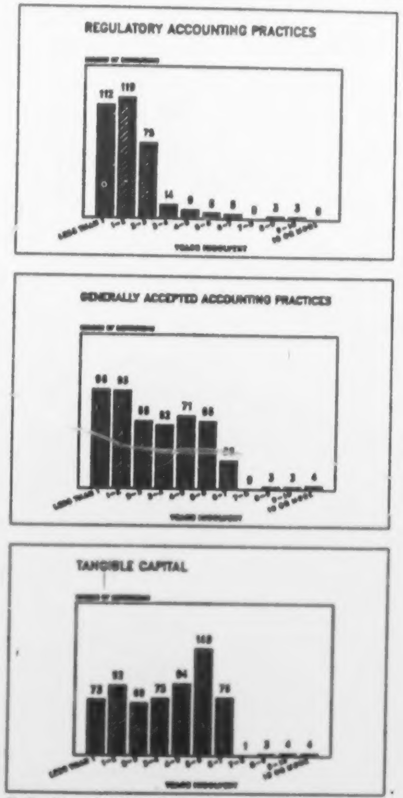
Use of Enforcement Powers by the FHLBB*

Year	Cease & Desist Orders	Removal of Officers	Supervisory Agreements	Formal Investigations
1975	13	-	10	41
1976	8	-	41	46
1977	13	-	14	21
1978	9	-	9	37
1979	7	4	7	20
1980	3	1	-	6
1981	8	2	0	8
1982	13	6	5	10
1983	17	21	39	17
1984	13	22	116	24
1985	28	22	233	30
1986	58	48	214	30

Source: Strunk and Case, Ibid., p. 125

*Comparing the extent of FHLBB's use of enforcement actions to the use of such actions by the federal bank regulatory agencies is complicated by differences in the numbers and sizes of institutions under the respective agencies.

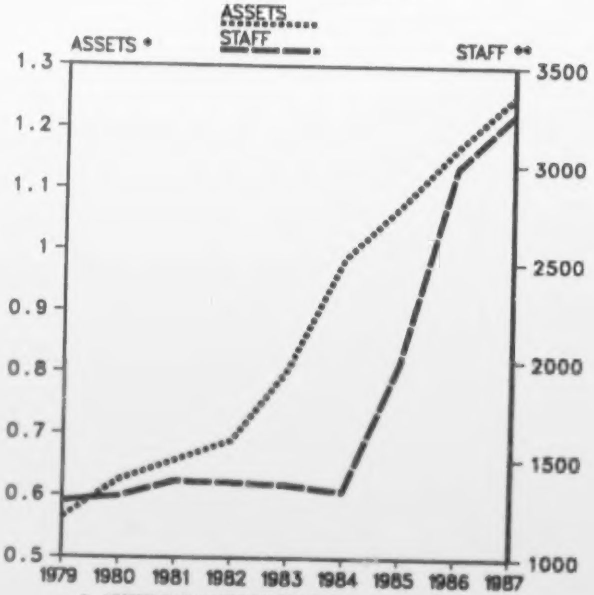
GRAPH 1
LENGTH OF INSOLVENCY OF INSOLVENT S&Ls



Source: James R. Barth and Michael G. Bradley. ThriftDeregulation and Federal Deposit Insurance. Office of Policy andEconomic Research, FHLBB.

GRAPH 2

THRIFT REGULATORY STAFF AND INDUSTRY ASSETS



* ASSETS IN BILLIONS OF DOLLARS.

** STAFFING FIGURES BASED ON FULL-TIME EQUIVALENT PERSONNEL ENGAGED IN EXAMINATION AND/OR SUPERVISION AT BOTH THE BANK BOARD AND DISTRICT BANKS.

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Federal Administrative Counsel

Henry Ruempler
Tax Counsel

Conclusion

Mr. Chairman, we appreciate this opportunity to testify today. The legislation before you makes critical changes to the nation's financial system. While we realize the urgent need to act quickly, we hope that at the same time Congress will be able to take great care in crafting the final bill. We have included an addendum to this testimony that we hope will be helpful in this regard. It is essential to our members that the final legislation be equitable and workable for them.

The **Chairman**. Thank you, Mr. Rideout.

Before we hear from our third witness, I'm going to call on the other members that have joined us. We have a number of other hearings going on at the same hour, so, members are coming and going as they are able to. Let me now ask Senator Shelby, did you have an opening comment you wanted to make?

Senator **Shelby**. Mr. Chairman, I have an opening statement. I ask unanimous consent that it be made part of the record and that way we can move on with the hearing.

The **Chairman**. Without objection, so ordered.

[Committee insert of Senator Shelby's opening statement follows:]

STATEMENT BY SENATOR RICHARD SHELBY

Senator **Shelby**. Mr. Chairman, I would like to welcome today's witnesses here. The banking industry is affected by this legislation and it is appropriate that we seek the industry's comments.

Gentlemen, I have read your prepared statements and have found them to be very helpful and full of constructive comments.

The administration's proposal will increase bank insurance premiums significantly for a limited amount of time. While I have heard token complaints, the banking industry as a whole seems to understand that this money is not going toward the S&L industry cleanup and that premium increases are warranted in light of the losses recently suffered by the FDIC. I appreciate the spirit of cooperation that your industry has displayed on this issue.

It seems that our mutual support for the administration's proposal hinges on one crucial element and that is that this legislation will not impede the dynamics of the marketplace. The paths followed by the banking and thrift industries are converging; thrifts are rounding out their portfolios with more commercial lending while banks are becoming increasingly willing to originate mortgages. Securitization has reduced the risk of mortgage lending to both industries.

The differences between the two businesses are narrowing; indeed the Independent Bankers Association endorses Chairman Wall's idea to make advances from the Federal Home Loan Banks available to community banks with large mortgage portfolios.

Although more than nine times out of ten, the community bankers are at odds with the financial services council, I believe that making Federal Home Loan Bank advances available to banks is consistent with the Financial Services Council philosophy of functional regulation.

It is incumbent upon all industry participants, and Congress, and the administration to accept the fact that the financial services marketplace is changing. Our regulatory structure is no longer appropriate for the metamorphosis that financial services have undergone. It is important that this legislation does recognize the industry's transformation and sets up a structure that will not impede changing regulation. However, I feel very strongly that whatever we will be able to do in this bill will not be enough. It is important that we take a broader look at the financial services industry after resolving this crisis. The chairman has been frank about his interest in addressing this issue and I look forward to working on reform immediately after we complete this legislation.

Once again, I appreciate your cooperation with this committee and look forward to the question and answer period.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Mack, did you have an initial comment that you wanted to make?

Senator MACK. No, Mr. Chairman. I'm ready to proceed with the questions.

The CHAIRMAN. Very good. Senator Dixon.

Senator DIXON. Mr. Chairman, I have an opening statement I ask unanimous consent be put in the record.

The CHAIRMAN. Without objection, so ordered.

[Committee insert of Senator Dixon's opening statement follows:]

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee continues its hearings on the problems of the thrift industry. I look forward to hearing the testimony of William Haraf of the Financial Services Council, the president of the American Bankers Association Thomas Rideout, and the president of the Independent Bankers Association, Jay Tomson.

Last week, OMB Director Richard Darman admitted that the numbers used in the Treasury plan's estimates are optimistic. Also last week, the Congressional Budget Office in its testimony stated that the Treasury's obligations are openended, and that the Treasury could end up paying $110 billion or more, not just OMB's estimate of $40 billion—should interest rates, deposit growth, or economic growth prove less favorable.

The administration's proposal may get us through 1989, but I do not believe that its numbers work for later years. In any event, the Resolution Trust Corporation will resolve only those thrifts which are currently insolvent or become so over the next 3 years; resolution of insolvencies after 1992 will be on-budget.

I intend to work diligently with Chairman Riegle and other committee members, including in particular the chairman of the Budget Committee, to meet the 45 day deadline called for by President Bush. Even with such a short timeframe, the Senate would not be upholding its legislative obligations if we did not ask the administration how the FSLIC resolution fits into the rest of the budget, now and in the post-RTC years. It will be difficult to meet that 45 day deadline if we do not have a budget agreement with the administration within that same time period.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. I have no opening statement, Mr. Chairman.

The CHAIRMAN. Senator Bryan.

Senator BRYAN. No opening statement, Mr. Chairman.

The CHAIRMAN. Senator Pressler.

Senator PRESSLER. I have a brief opening statement. I'll place it in the record.

The CHAIRMAN. Very good. We'll make that a part of the record.

OPENING STATEMENT OF SENATOR PRESSLER

Senator PRESSLER. Thank you. Mr. Chairman, I again commend you for moving forward so promptly with these very important hearings on the crisis in our thrift industry. This certainly is one of the most urgent pieces of legislation we are to consider in this session of the 101st Congress. I hope we can move it rapidly here and with like action being taken in the House of Representatives.

I look forward to hearing the testimony of our witnesses.

The CHAIRMAN. With that, Mr. Tomson, we'd like to hear from you now.

STATEMENT OF O. JAY TOMSON, PRESIDENT, INDEPENDENT BANKERS ASSOCIATION OF AMERICA, CHAIRMAN, CITIZENS NATIONAL BANK OF CHARLES CITY, CHARLES CITY, IA

Mr. TOMSON. Thank you.

Mr. Chairman, distinguished members of this committee, my name is O. Jay Tomson. I am president of the Independent Bankers Association of America and I am speaking for only one constituency and that is the thousands of community banks of this Nation. I also serve as chairman of the Citizens National Bank of Charles City, IA and I'm glad to see you have some Iowa weather down here this morning.

We strongly commend President Bush for the leadership he has shown in recognizing the seriousness of this problem and proposing a bold plan to come to grips with it. We strongly support the President's insistence that basic structural reform accompany the bailout of the FSLIC. We regard this legislation as a unique opportunity to build a stronger deposit insurance system and a stronger and fairer regulatory and supervisory structure. We urge prompt action on the proposal since we fear that delay will further undermine consumer confidence in our Nation's financial system.

Our first and strongest recommendation is that the insurance assessment base be broadened to include foreign deposits and other nondeposit liabilities which the largest banks use to fund most of their lending. According to our calculations—based on FDIC data—broadening the assessment base would permit Congress to keep the proposed new insurance assessment on banks at 12 cents per $100 of deposits and bring the FDIC to its target reserve level more quickly.

Not only would this lower the costs to most banks, it would be more equitable than the administration's proposal. Banks with over $30 billion of assets—11, which are clearly considered in the "too big to fail" category—fund only 38 percent of their assets with deposits subject to insurance assessments. In contrast, banks under $100 million in assets—there are some 10,500 of these institutions—fund over 88 percent of their assets with assessable deposits. This means that the smaller banks pay a much higher premium in relation to their asset size than do the larger banks, but are denied the 100 percent deposit insurance enjoyed by the too big to fail banks. In turn, these larger banks present a systemic risk to the deposit insurance system which smaller banks do not. The premium insurance assessments posed in the Bush plan perpetuate inequities that favor the large commercial banks and we think that should be changed.

Regarding credit unions, the administration's bill does meet the equity test in one crucial respect. It requires credit unions, which now pay no deposit insurance premiums, to begin expensing the 1-percent deposit they maintain with the credit union insurance fund.

We understand that the credit unions have asked Congress to exempt them from this legislation on the grounds that they had no part in creating the S&L problem and that their fund is not in trouble. But much the same thing might be said of the vast majority of commercial banks in this country.

In the interest of safety and soundness Congress should consider other credit union reforms. As the FSLIC crisis demonstrates, there is considerable danger in permitting one agency to both charter and insure financial institutions. But the National Credit Union Administration presents just this situation. Why wait for another crisis to develop? Congress should seriously explore separating the chartering and promotion function from the insurance responsibility, especially since that insurance responsibility is now so clearly the responsibility of the taxpayers.

In the face of Black Monday in October 1987, the Federal Reserve stepped in and assured hard-pressed securities firms that it would ensure that the Nation's financial system, including the stock market, had sufficient liquidity. Of course, Merrill Lynch did not—except for its nonbank bank—pay any deposit insurance premiums for this Federal backstop. And no securities firm and no money market mutual fund posts reserves with the Federal Reserve. We strongly recommend that, at a bare minimum, money market mutual funds post reserves with the Fed.

Several points are vital to ensuring the integrity of deposit insurance. First, Congress should reject any proposals to lower the current $100,000 level of coverage. Second, only commercial banks should be permitted to display the FDIC logo. Third, Congress should take every step necessary to ensure that the commercial banks, FDIC fund will remain completely separate from the new savings and loan fund.

I think the logo issue is an emotional issue for bankers. We've paid insurance premiums year after year, many for us for as long as the FDIC sticker has been available, for the privilege of displaying that sticker, and now the thrift industry, which has run itself and its insurance fund into the ground, wants to take that 50 years of good standing for their own use. I liken it to if Chrysler had asked this committee several years ago to call its cars Lincolns as part of the Chrysler rescue package, and we suggest the savings and loans get their good standing back the old-fashioned way, and not steal it from the commercial banks.

During our recent convention in Anaheim, CA, attended by approximately 2,000 community bank representatives, many bankers expressed strong concern about the new powers of the proposed deposit insurance board and about possible political influence over the board. We share Chairman Seidman's concern about the power of the President to designate a board member to sit as Chairman or Vice Chairman from time to time.

We recommend in the strongest possible terms that the Chairmen and the Vice Chairmen be appointed for specific terms, subject to Senate confirmation, and removable only for clear misconduct. They must be free to make the tough decisions and give Congress their honest views without the constant threat of removal.

For the past year the IBAA has strongly recommended equitable capital requirements, equitable accounting rules, equitable regulatory treatment, and equitable taxation for all of the insured depository institutions, including thrifts and credit unions. In many important respects the administration's plan meets this test. In addition, it would impose strong capital growth limits on thrifts that don't meet capital standards and on failed thrifts. These have been recommended by my Congressman, Representative Leach, for several years, and we applaud the administration for including them in this proposal.

In addition to the financial inequities in the administration's plan, it contains a significant competitive inequity. It permits thrifts and nonbank banks to market the products of their commercial parent companies and lets those companies market federally insured financial products. This new, sweeping, and unbalanced deregulation is ludicrously out of place as part of an expensive plan to clean up a mess caused in large part, we feel, by unwise deregulation and inadequate supervision.

Congress passed the limitations on cross-marketing as part of the Competitive Equality Banking Act of 1987. They ensure that nonbank banks and thrifts owned by ordinary commercial firms would not have an unfair competitive advantage over traditional commercial banks and thrifts that can engage only in strictly defined financial business.

Repealing these limits will undermine traditional banks and thrifts just when they are being asked to bear a large increase in costs to help bail out hundreds of failed thrifts. There is no reason why this repeal should be in this emergency proposal. It has little or no relevance to the FSLIC-S&L crisis, but it does strike at the important public policy that has dictated the complete separation of banking and commerce over the years.

Mr. Chairman, we have serious objections to title IX of the administration's bill, which provides sweeping new enforcement powers to the regulatory agencies. I think the banking industry is already one of the most highly regulated businesses in our economy and the banking agencies we feel have significant enforcement powers under current law.

Title IX would greatly expand these enforcement powers at the expense of due process rights of banks, and bankers and their officers and directors. We support changes to bring the enforcement powers of the thrift and credit union regulators up to parity with the current enforcement powers of the bank regulators. However, the sweeping changes in title IX we feel are overkill.

I might liken to in our home we don't use elephant guns to shoot gophers. A 22 will do sometimes.

The Chairman. I thought you were going to say an AK-47. That seems to be the weapon of choice these days.

Mr. Tomson. In conclusion, we are pleased to see that the administration's bill does not contain language that compromises the opportunities of State-chartered commercial banks to offer new products and services. While we understand that thrifts in several States abused wide-ranging State authorities, the records show that commercial banks and their State regulators have been careful and conservative in this area. Thank you.

[The complete prepared statement of O. Jay Tomson follows:]

T E S T I M O N Y

of

O. JAY TOMSON

PRESIDENT

OF THE

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

AND

CHAIRMAN
THE CITIZENS NATIONAL BANK OF CHARLES CITY
CHARLES CITY, IOWA

ON

S.413
THE FINANCIAL INSTITUTIONS REFORM, RECOVERY
AND ENFORCEMENT ACT OF 1989

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

WEDNESDAY, MARCH 8, 1989
534 DIRKSEN SENATE OFFICE BUILDING
WASHINGTON, D.C

Mr. Chairman, distinguished members of this Committee, my name is O.Jay Tomson and I am the president of the Independent Bankers Association of America. I am speaking for only one constituency and that is the thousands of community banks of this nation. I also serve as the chairman of the Citizens National Bank of Charles City, Iowa.

We strongly commend President Bush for the leadership he has shown in recognizing the seriousness of this problem and for proposing a bold plan to come to grips with this problem. We strongly support the President's insistence that basic structural reform accompany the bailout of the FSLIC. We regard this legislation as a unique opportunity to build a stronger deposit insurance system and a stronger and fairer regulatory and supervisory structure. We urge prompt action by the Congress on the President's proposal since we fear that delay will further undermine consumer confidence in our nation's financial system.

We have some recommendations that will make the President's program fairer and more equitable. Our recommendations also address the issue of the future regulatory and supervisory structure that this nation's community bankers would be comfortable with. These recommendations are put forward in the context of general support of the President's proposal and appreciation for the urgency with which the President and your Committee are approaching this very serious problem. Frankly, and I am speaking as a former Federal Reserve bank examiner, in my judgment we are facing the most serious depository institutions crisis in my lifetime. I wish that I could say that the average consumer of banking services clearly differentiates between a bank and an S&L--as one should--but he or she doesn't.

The following are our suggestions for strengthening and for making the proposed legislation more equitable.

The Premium Increase

Our first and strongest recommendation is that the insurance assessment base must be broadened to include foreign deposits and other non-deposit liabilities which the largest banks use to fund most of their lending. According to our calculations--based on FDIC data--broadening the assessment base would permit Congress to keep the proposed new insurance assessment on banks at 12 cents per $100 dollars of deposits AND bring the FDIC to its target reserve level more quickly.

Not only would this lower costs to most banks, it would be more equitable than the Administration's proposal. Banks with over $30 billion of assets--11 banks which clearly are considered "too big to fail"--fund only 38% of their assets with deposits subject to insurance assessments. In contrast, banks under $100 million in assets (some 10,500 institutions) fund over 88% of those assets with assessable deposits. This means that smaller banks pay a much higher premium in relation to their asset size than do the larger banks, but are denied the 100% deposit insurance enjoyed by the too-big-to-fail banks. In turn, these larger banks present a systemic risk to the deposit insurance system which smaller banks do not. The premium insurance assessments posed in the Bush plan perpetuate inequities that favor large commercial banks. They should be changed.

Assessing foreign deposits and other liabilities at $.083 per $100 would give the FDIC an additional $473 million annually. Increase that assessment to $.12 per $100 and it yields $710 million annually. Assume a modest growth rate of 4% in these liabilities and by 1993 the FDIC could earn an additional $1.4 billion in annual income--and that's keeping the assessment at $.12. Bottom line: under the IBAA plan, the FDIC fund would be at $29 billion in 1993, or $1.4 billion more than under the Bush/Darman plan (see details in attached appendices). A fairer, broader assessment base can lead to a lower across-the-board premium for all commercial banks while gaining more revenue for the FDIC than does the Bush proposal. This comparison is particularly apt, since the increase in commercial bank premiums is in large part being imposed to provide a budgetary offset for spending on the thrift crisis.

Credit Unions

The administration's bill does meet the equity test in one crucial respect. It requires credit unions--which now pay no deposit insurance premiums--to begin expensing the 1% deposit they maintain with NCUSIF. Credit unions enjoy sizable advantages over other financial institutions. They pay no federal tax and typically pay no rent for their office space. It should come as no surprise that they can offer higher rates to their depositors and lower rates to their borrowers.

And, of course, credit unions are no longer sleepy little operations serving a narrow field of membership. They have broad retail deposit taking and lending authority and their potential field of membership under recent regulations knows virtually no bounds. The newly-chartered AARP credit union makes this absolutely clear. Anyone over 50 years of age qualifies for membership.

We understand that the credit unions have asked Congress to exempt them from this legislation on the grounds that they had no part in creating the S&L problem and that their fund is not in trouble. Much the same thing might be said of the vast majority of commercial banks. And, until the failure of several huge banks last year we expected the FDIC fund to continue to grow. Even without a premium increase the FDIC may resume its growth this year.

And, we should keep in mind that the insurance accounting treatment that the credit unions wish to preserve for NCUSIF is the same as that used for Ohio and Maryland savings and loan funds. When those funds were strained S&Ls had to quickly write off the insurance "deposits" which they had counted as assets, making it difficult for even healthy S&Ls to survive.

Credit unions also argue that they are not-for-profit and member-owned so they could not function under a system designed to guard against risks facing for-profit institutions. The fallacy in this argument is that credit union products and services compete with for-profit institutions, and compete very well. The credit unions' insurance fund should reflect that the credit union industry is subject to for-profit risks.

In the interest of safety and soundness Congress should consider other credit union reforms. As the FSLIC crisis demonstrates, there is considerable danger in permitting one agency to both charter and insure financial institutions. But the National Credit Union Administration presents just this situation. Why wait for another crisis to develop; Congress should seriously explore separating the chartering and promotion function from the insurance responsibility, especially since that insurance responsibility is now so clearly the responsibility of the taxpayers.

Money Market Mutual Funds

In the face of Black Monday in October of 1987 the Federal Reserve stepped in and assured hard-pressed securities firms that it would ensure that the nation's financial system, including the stock market, had sufficient liquidity. Of course, Merrill Lynch did not (except for its nonbank bank) pay any deposit insurance premiums for this federal backstop. And, no securities firm and no money market mutual fund posts reserves with the Federal Reserve.

But, as Black Monday demonstrated, the federal safety net stands behind securities firms and mutual funds just as much as it stands behind the banking and thrift industries. Yet, the administration's plan makes no mention of them. This is a significant hole. Therefore, we strongly recommend that--at a bare minimum--money market mutual funds post reserves with the Fed.

Integrity of Deposit Insurance

Several points are vital to ensuring the integrity of deposit insurance. First, Congress should reject any proposals to lower the current $100,000 level of coverage. Second, only commercial banks should be permitted to display the FDIC logo. Third, Congress should take every step necessary to ensure that the commercial banks' FDIC fund will remain completely separate from the new savings and loan fund.

Reducing deposit insurance coverage, as was suggested by the Reagan Administration's final economic report, would be grossly unfair to the nation's small- and medium-sized banks which lack too-big-to-fail, 100% insurance, status. We anticipate that deposits would flow into those banks that the government will not permit to fail.

Not all depositors with over $100,000 are sophisticated enough to pore over call reports and financial statements to determine the strength of their bank. They would have to pull some of their funds out of smaller banks to make sure they had full insurance coverage.

The "logo" issue is emotional for bankers. Many have paid insurance premiums year after year--some for as long as the FDIC sticker has been available--for the privilage of displaying that sticker. All the while their banks have not cost the FDIC fund one single dime--all they have gotten for their premiums is the right to put "FDIC" on their doors. Now, the thrift industry, which has run itself and its insurance fund into the ground, wants to take that 50 years of good standing for its own use. It's as if Chrysler had asked this Committee several years ago to permit it to call its cars "Lincolns" as part of the Chrysler rescue package. We suggest the savings and loans get their good standing back the old fashioned way, and not steal it from the commercial banks.

We are particularly offended that the banks' insurance fund will no longer be "FDIC." Frankly, Mr. Chairman, "BIF" just doesn't cut it. The FDIC label for the commercial bank insurance fund has worked well. "If it ain't broke, don't fix it." The "bank insurance fund" should remain simply the "FDIC" and the board that oversees the two insurance funds should get an entirely new name, perhaps the Deposit Protection Board.

On the other hand, we applaud the repeated assurances that the FDIC will remain separate from the FSLIC. As a banker, I cannot hear that music enough. However, we are concerned about several features of the legislation that would undermine that separateness. We have identified them in an addendum to this testimony.

Independence of the FDIC

During our recent convention, attended by approximately 2000 community bank representatives, many bankers expressed strong concern about the new powers of the proposed deposit insurance board and about possible political influence over the board. We share Chairman Seidman's concern about the power of the President to designate a board member to sit as chairman or vice chairman "from time to time." Will a chairman wake up one morning to discover that for political reasons he is no longer the designated chairman? And will the replacement chairman, if he is a current board member, be subject to Senate confirmation?

These kinds of questions are too horrible to contemplate, especially with the example of the Federal Home Loan Bank Board so fresh in our minds. We recommend in the strongest possible terms that the chairmen and vice chairmen be appointed for specific terms, subject to Senate confirmation, and removable only for clear misconduct. They must be free to make the tough decisions and give Congress their honest views without the constant threat of removal.

We also believe that a board with the new powers granted in the administration's bill should be broader based and better insulated from political influence. In that regard, it should be expanded to

include 5, rather than 3, public members (for a total of 7). And its members should be given long, and staggered, terms to avoid rapid turnover whenever a new administration takes office. We also believe that its members should have a diverse background, including geographic balance. It should represent all dimensions of the industry. The Board of Governors of the Federal Reserve System would provide this Committee a useful model. We should not be concerned about the additional administrative expense of a larger board; we are now spending billions to clean up a problem caused in part by excessive political influence and it will be well worth the cost to prevent that problem in the future.

Equitable Regulation

For the past year the IBAA has strongly recommended equitable capital requirements, equitable accounting rules, equitable regulatory treatment, and equitable taxation for all insured depository institutions including thrifts and credit unions. In many important respects, the administration's plan meets this test. In addition, it would impose strong growth limits on thrifts that don't meet capital standards and on failed thrifts. These have been recommended by my Congressman, Representative Leach, for several years and we applaud the administration for including them in its proposal.

Cross Marketing Restrictions

In addition to the financial inequities in the administration's plan it contains a significant competitive inequity. It permits thrifts and nonbank banks to market the products of their commercial parent companies and lets those companies market federally insured financial products. This new, sweeping, and unbalanced deregulation is ludicrously out of place as part of an expensive plan to clean up a mess caused in large part by unwise deregulation and inadequate supervision.

Following the strong leadership of Chairman Volcker, Congress passed the limitations on cross-marketing as part of the Competitive Equality Banking Act of 1987. They ensure that nonbank banks and thrifts owned by ordinary commercial firms would not have an unfair competitive advantage over traditional commercial banks and thrifts that can engage only in strictly defined financial business.

Repealing these limits will undermine traditional banks and thrifts just when they are being asked to bear a large increase in costs to help bail out hundreds of failed thrifts. There is no reason why this repeal should be in this emergency proposal; it has little or no relevance to the FSLIC/S&L crisis. But it does strike at the important public policy that has dictated the complete separation of banking and commerce.

In our view, banking firms should not be selling automobiles and car dealers should not be peddling certificates of deposit. Not only is it inequitable, it could lead to further concentration in the economy. Powerful commercial and financial conglomerates could push traditional firms, be they financial or commercial, into small corners of the economy.

Lifting the cross marketing restrictions is also anti-consumer. It will permit companies to package financial and non-financial products together in ways that will almost certainly generate confusion. The widely touted low-rate auto financing programs illustrate how this happens. Consumers are lured to dealerships with the promise of absurdly low rates, only to find out that these rates are only available for very-short terms or just on unpopular models. In many cases, consumers wind up paying higher rates for loans arranged by the dealership while banks and thrifts have little chance to compete.

We urge you to completely reject this ideological spasm of the Treasury's deregulation agenda. It is entirely out of step with reality and will result in increased concentration, and hurt healthy banks and thrifts as well as consumers.

Acquisition of Healthy Savings and Loans

The IBAA is strongly opposed to acquisition of healthy savings and loans by commercial firms and bank holding companies. While cross marketing restrictions are helpful, it would be far better to maintain separation of the thrift industry from commercial interests and bank holding companies. In this regard, it is important that state restrictions be honored.

Enforcement Provisions

Mr. Chairman, we have serious objections to Title IX of the administration's bill, which provides sweeping new enforcement powers to the regulatory agencies. The banking industry is already one of the most highly regulated businesses in our economy and the banking agencies have significant enforcement powers under current law.

Title IX would greatly expand these enforcement powers at the expense of due process rights of banks, their officers and directors. Let me give you an example of one of the most onerous provisions of Title IX.

Section 905 of the bill drastically increases the civil money penalty for filing a late report from $100 per day to $25,000 per day. This would impose a tremendous burden on a small bank which inadvertently missed a filing date. Even worse, the bill goes beyond the issue of timeliness to give the regulators discretion to impose this huge penalty based on the content of the report. If, in the sole judgement of the regulator, the report contained false, misleading or incomplete information, the $25,000 penalty could be imposed. This is contrary to basic principles of due process and creates great opportunities for abuse of the regulatory process.

Title IX greatly expands the power of the regulators to use cease and desist orders. It broadens the scope of potential enforcement targets to any "institution-related party," which could have a serious chilling effect on potential investors.

We support changes to bring the enforcement powers of the thrift and credit union regulators up to parity with the current enforcement powers of the bank regulators. However, the sweeping changes in Title IX are overkill.

State-Authorized Powers for Commercial Banks

We were pleased to see that the administration's bill does not contain language that compromises the opportunities of state-chartered commercial banks to offer new products and services. While we understand that thrifts in several states abused wide-ranging state authorities, the records show that commercial banks and their state regulators have been careful and conservative in this area. Fundamentally, we see no incompatability between states rights and safety and soundness. We recommend that you accept the administration's judgement in this area.

RTC Asset Disposition

Mr. Chairman, we have some serious concerns about the asset disposition policies of the Resolution Trust Corporation. Under the administration's bill, the RTC would become the manager of billions of dollars of assets across the country. Section 501 of the bill provides that the RTC would contract with the new FDIC and private firms for the management and eventual disposition of these assets. We are very concerned about the impact of this process on already depressed real estate markets.

I understand that Senator Wirth and other members of the Committee have raised similar concerns. We urge the Committee to add language to the bill to require the RTC and its agents to fully consider the economic impact of its actions on the local communities and local real estate markets and to take all possible steps to minimize any adverse economic affect.

Community Bank Access to Federal Home Loan Bank Advances

Chairman Wall and others have suggested that community banks be granted access to Federal Home Loan Bank advances. We think this is an excellent idea. Many community banks provide a large number of mortgage loans to their communities, a fact which should be recognized. At the same time, it is important to note that even these community banks are also responsible for consumer, small business, and agricultural lending, so that their mortgage portfolios may not reach quite the level of a traditional savings and loan. Nevertheless, we think that it would be appropriate to grant some access to FHL Bank advances to commercial banks which do make a substantial commitment to home mortgage lending.

Conclusion

Mr. Chairman, we appreciate this opportunity to testify today. The legislation before you makes critical changes to the nation's financial system. While we realize the urgent need to act quickly, we hope that at the same time Congress will be able to take great care in crafting the final bill. We have included an addendum to this testimony that we hope will be helpful in this regard. It is essential to our members that the final legislation be equitable and workable for them.

Modification - Add assessment of foreign deposits and other liabilities
Raise premium to .12

FDIC
(in billions)

Premium Assessment	(.083) 1989	(.12) 1990	(.12) 1991	(.12) 1992	(.12) 1993	(.12) 1994
Total Domestic Deposits	2,350	2,470	2,600	2,750	2,890	3,034
Insured Deposits	1,760	1,850	1,950	2,060	2,170	2,275
Foreign Deposits*	350	364	378	393	408	424
Other Liabilities	220	231	243	255	268	281
Total Accessible	2,920	3,065	3,221	3,398	3,534	3,739
Total Insured Base*	1,931	2,028	2,134	2,254	2,372	2,486
Assessment Income	2.4	3.67	3.86	4.08	4.24	4.47
Investment Income	1.12	1.16	1.34	1.6	1.96	2.4
Express	3	2.5	2	1.5	1.	1.
Fund	14.5	16.8	20.	24.2	29.4	34.87
Presidents Plan/FDIC	14	15.6	18.75	22.875	28	33.4
Excess in Fund over President's Plan	(+.5)	(+1.2)	(+1.25)	(+1.3)	(+1.4)	(+1.5)
*Coverage ratio including 30% of foreign deposit and other liabilities	.75	.83	.94	1.07	1.24	1.51
Insured Deposits only coverage ratio	.80	.84	1.03	1.17	1.35	1.65

Assumptions
-5% annual growth in assessible domestic deposits
-insured deposits/total deposits = 75%
-FDIC yield on Treasuries @ 8%
-4% growth in foreign deposits
-5% growth in other liabilities

DISTRIBUTION OF BANKS CURRENTLY ON 9/30/88 CALL FILE

Commercial Banks			(in billions)	Premium Assessment (in millions) .083	.12	.15
# Banks < 25 million		=	4,290			
Aggregate Assets		=	64.6			
Aggregate Deposits	(89%)	=	56.8	47	68	85.2
# Banks 25-100 million		=	6,178			
Aggregate Assets		=	315.8			
Aggregate Deposits	(88%)	=	280.9	233	377	421.4
# Banks 100 - 300 million		=	1,864			
Aggregate Assets		=	301.6			
Aggregate Deposits	(87%)		264.2	219	316.9	396.1
# Banks 300 - 1000 million		=	545			
Aggregate Assets		=	274.7			
Aggregate Deposits	(82%)	=	225.9	187.5	271.	338.9
# Banks 1 - 5 Billion		=	268			
Aggregate Assets		=	579.9			
Aggregate Deposits	(73%)	=	424.3	352	509.2	636.5
# Banks 5 - 30 Billion		=	86			
Aggregate Assets		=	843.4			
Aggregate Deposits	(62%)	=	525.5	432	624.6	780.8
# Banks > 30 Billion		=	11			
Aggregate Assets		=	718.8			
Aggregate Deposits	(38%)	=	274.4	228	329.3	411.6
Total # Banks		=	13,242			
Total Reported Assets		=	3,095			
Total Reported Deposits		=	2,047	1,700	2,496	3,071

Mutual Savings Banks		(in billions)	Premium Assessment (in millions) .083	.12	.15
# MSB < 25 million	=	26			
Aggregate Assets	=	.4			
Aggregate Deposits	=	.3	.25	.36	.45
# Banks 25-100 million	=	128			
Aggregate Assets	=	7.9			
Aggregate Deposits	=	6.9	5.7	8.3	10.4
# Banks 100-300 million	=	162			
Aggregate Assets	=	29.9			
Aggregate Deposits	=	25.6	21.2	30.7	38.4
# Banks 300-1000 million	=	107			
Aggregate Assets	=	57.3			
Aggregate Deposits	=	46.9	38.9	56.3	70.4
# Banks 1-5 million	=	45			
Aggregate Assets	=	91.6			
Aggregate Deposits	=	72.9	60.5	87.5	109.4
# Banks 5-30 billion	=	5			
Aggregate Assets	=	47.7			
Aggregate Deposits	=	34.0	28.2	40.8	51.
# Banks > 30 billion	=	0			
Aggregate Assets	=	0			
Aggregate Deposits	=	0			
Total # Banks	=	473			
Total Reported Assets	=	234.8			
Total Reported Deposits	=	186.8	155.0	224.2	280.2

Distribution By Charter Class		Agg. Assets (In billions)
National	4,395	1,821
Nonmember	7,777	725
State Member	1,070	594

Modification to Treasury plan--increase premium to .12 and add assessment of foreign deposits and other liabilities

The modification would increase the bank premium to .12 per $100 of total domestic deposits and assessments would be made against foreign deposits and a broader category of other liabilities.

Assessment schedule would be as follows:

	Bank	Thrift
1989	.083	.208
1990	.12	.208
1991	.12	.23
1992	.12	.23
1993	.12	.23
1994	.12	.18

Other liabilities would include repurchase agreements, both wholesale and retail, and all other borrowed money. This would include the non-deposit liabilities such as promissory notes and collateralized borrowings such as municipal deposits that have been pledged with pledgeable securities. These figures are attainable from the call report.

The premium income from assessing foreign deposits and other liabilities is not insignificant--it would have been approximately $473 million in 1988. The following table illustrates the income potential if foreign deposits and other liabilities were assessed.

(in billions)

	Foreign Deposits	+	Other Liabilities	=	Total	Premium Assessment .083	.12	.15
1989	350		220		570	.47		
1990	364		231		595		71	
1991	378		243		621			.93
1992	393		255		648			.97
1993	408		268		676			1.01
1994	424		281		705			1.06

Additional Concerns

Deposit Insurance Fund (Sections 207 and 208)

It is our understanding that the references to the Deposit Insurance Fund and its accompanying reserve ratio test found in the bill are drafting errors and will be eliminated in the final version of the bill. The IBAA strongly opposes this language since it undermines the promise that the funds will not be commingled. Of special concern is the reference to an additional reserve ratio test, which has been defined as the net worth of the Deposit Insurance Fund to the value of aggregate insured deposits held by all insured financial institutions. Such a test would eliminate any semblance of the bank and thrift funds truly being separate. However, the Treasury has assured us that this offending language will be removed and that they will recommend that the legislative history will mention this to prevent any inadvertent oversights.

Limitation on Liability (Section 206.(5))

The bill provides for a five year limitation for a SAIF fund member incurring any liability to the Corporation from assistance provided to or loss incurred as a result of the default of a BIF member. BIF members are given the same 5 year limitation on liability. If the funds are in fact never to be commingled, then the language on the liability of BIF members for SAIF losses and SAIFs member for BIF losses should read that the respective members will never incur liability for losses in the other funds. Without language this strong, the specter of an eventual merger of the funds will forever be over the heads of banks.

Liability of Commonly-Controlled financial Institutions (Section 206)

The IBAA is concerned about the language found in the bill regarding the liability of commonly-controlled institutions. Under S. 413, whenever the FDIC incurs a loss in connection with the default of an insured financial institution, or in connection with providing assistance to an insured financial institution in danger of default, any other commonly-controlled insured financial institution shall be liable to the Corporation. The IBAA believes this language is unnecessarily broad and has confused common individual ownership with corporate ownership. Common individual ownership does not mean that the financial institutions behave as a single entity.

Under banking law, control is usually defined as ownership of 25 percent of the voting stock of an institution. However, it is possible to consider an institution under common control when as little as 5 percent of the stock is owned by an individual. The fact that one individual or family owns or controls 5 percent of the stock of several institutions does not provide justification to hold the other 95 percent of shareholders liable for the actions or losses of another institution.

The language in the bill should explicitly refer to the responsibility of shareholders to their financial institution. Broad references to commonly-controlled financial institutions fail to identify the distinction between forms of corporate ownership. Extending liability to any commonly-controlled institutions could unnecessarily weaken the financial system and all but eliminate the idea of effective firewalls through distinct forms of ownership.

Assessment Rates and Rebates (Section 208)

Under the Administration's bill, banks should achieve their target reserve level by 1993. After the target reserve level is attained, banks are eligible for an assessment credit equal to 60 percent of the net assessment income. However, "net assessment income" is defined as the total assessments which become due during the calendar year less: the operating costs and expenses of the Corporation for the calendar year,...additions to reserve for insurance losses, and several other factors. Our reading of this language indicates that the Corporation's overhead costs and expenses for operating both funds will be aggregated. This is unacceptable to bankers.

If, as the bill states, two insurance funds are established both to be operated and administered by the Corporation, and to be separately maintained and not commingled, then the costs must be segregated for operating and maintaining two separate and distinct funds. To link the banks rebates to the overhead costs of both funds undermines the separateness of the two funds. The costs to administer the thrift fund will undoubtedly be much higher, especially in the beginning, and the banking industry does not want to indirectly pay these thrift expenses. The IBAA believes that the Corporation should be required to set up two separate sets of books to monitor and account for the operating expenses attributable to each industry. Assessment increases and credits must be linked to the operating costs of each separate and distinct fund. Only by not commingling operating costs and expenses will the promise of no merger of the funds truly be kept.

The bill provides for an annual maximum increase in the premium of 50 percent with an annual assessment cap of 35 basis points. Insurance costs of 35 cents per $100 is unrealistically high. Also the FDIC is not bankrupt. Yes, the fund has undergone exceptionally high losses in the past few years. But for over 50 years the fund has been soundly managed. To bring the fund back up to acceptable reserve levels, the IBAA strongly supports broadening the assessment base to encompass all the liabilities of the fund which have enjoyed de facto insurance. Furthermore, we believe a premium increase to 12 cents per $100 in warranted. However, accepting a legislated maximum of 35 cents per $100 is not possible. As community bankers, we strongly believe that a premium this high could eliminate many community banks which do not have the options to utilize alternative

non-assessed sources of funding. Even at 15 cents per $100, some 87 banks under $100 million in assets would be made unprofitable. We urge that the cap be set at a more realistic figure. Premiums of 35 cents per $100 could restore a depleted FDIC fund only at the cost of failing hundreds of community banks. We believe that this cost is too high.

Reports of FDIC to Treasury and OMB (Section 217)

The independence of the FDIC Board is of importance to the IBAA, which is why we recommended the expansion of the FDIC board. Part of this independence must include the FDIC's ability to take appropriate and timely action without being hampered by unnecessary paperwork. The IBAA is concerned that the quarterly reporting requirements contained in the bill might be unduly restrictive on the Corporation's activities.

Of particular concern is that the Corporation will be required to submit quarterly its operating plans and forecasts, including estimates of actual and future spending, and estimates of actual and future non-cash obligations. We see no reason that an independent board should be required to submit quarterly reports, especially on prospective actions and spending. We believe that this reporting procedure would be unduly cumbersome and has the possibility of interfering with the timely resolution of bank and thrift failures. We urge reconsideration of the quarterly reporting requirement.

Pledgeablity of REFCO Bonds (Section 502)

The IBAA supports the provision in the bill which will permit the obligations issued by the Funding Corporation, to be considered lawful investments that may be accepted as security for all fiduciary, trust, and public funds. The pledgeability of this asset should provide additional incentive for financial institutions to purchase the bonds.

In Danger of Default (Section 204 and 802)

The bill defines the term "in danger of default" with respect to an insured financial institution. In danger of default means that in the judgement of the chartering authority, the financial institution is not likely to be able to meet the demands of its depositors or pay its obligations (emphasis added); and there is no reasonable prospect that it will be able to meet such demands or pay such obligations; or the financial institution has incurred or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for replenishment of its capital (emphasis added).

Under Section 802, the language permits the Comptroller of the Currency upon determining that the above defined situation exists, to appoint a conservator, without notice, to the financial institution. (emphasis added) The IBAA supports timely enforcement action by the regulators, but not without adequate due process being accorded to the financial institutions. The language which we emphasized provides a tremendous amount of discretionary and subjective authority to the regulators, without providing any means of recourse to the affected party. Regulators have been known to be wrong, to make an incorrect assessment of a situation, and to fail to adequately communicate with the "guilty" party as to the extent of the problems. The strengthening of the examination forces also means that many of the examiners making these judgements will be new, with little or no experience. Is it fair to put the fate of a financial institution into the hands of a novice? The IBAA cannot support language which provides such carte blanche authority to regulators to make judgements without any discernible form of recourse to the affected banks. Regulators are fallible, and until they become infallible protections must be given to those that they regulate.

The **Chairman**. Thank you very much.

Let me start the questioning. I want to first of all put a question that I would hope you could all try to answer yes or no. I've tried to phrase it in a way that that's fair.

Each of you have made various comments about aspects of the plan, but taking it as a whole, let me ask each of you if you think that the administration's plan is generally fair to the thrift industry? Do you think it is?

FAIRNESS OF THE PLAN

Mr. **Haraf**. Mr. Chairman, I think it's a useful first step.

The **Chairman**. That sounds to me like a sidestep rather than an answer. You sound like there are other steps that are immediately needed. So this is not a step that we can take by itself?

Mr. **Haraf**. Well, Mr. Chairman, it's hard to give a yes or no answer with respect to the entire bill. I think that there are provisions in this bill that are fair. I think it does make sense to bring savings and loans up to the capital and regulatory standards of banks. It is the most important aspect of this bill and we be support it.

The **Chairman**. That's why I phrased it the way I have and that is, taken as a whole—in other words, obviously there are things that you might change about it, but if you take the whole package, is it generally fair to the thrift industry?

Mr. **Haraf**. We think it is on balance a positive step.

The **Chairman**. Mr. Rideout, what is your answer on that?

Mr. **Rideout**. We would agree that it is fair, yes, sir.

The **Chairman**. Mr. Tomson.

Mr. **Tomson**. We would give it a qualified yes.

The **Chairman**. How about its impact of the plan on the banking industry? Do you think the impact of this plan on the banking industry is generally fair?

IMPACT OF PLAN ON BANKING INDUSTRY

Mr. **Haraf**. Yes, Mr. Chairman. We think it's reasonable.

Mr. **Rideout**. Mr. Chairman, it's fair, but it's very painful. It's very expensive in terms of our bottom line, but we want to be a part of solving the problem and we're willing to pay this price as outlined in the bill.

The **Chairman**. Mr. Tomson.

Mr. **Tomson**. Well, there are three aspects to that. I feel that certainly as a community bank we want to keep the level of insurance in place. It's doing that. As far as the costs, we've made some suggestions as to how we might at least analyze it a little more closely. In terms of safety and soundness, I believe it is accomplishing much.

The **Chairman**. So is it generally fair, in your view, to the banking industry, as you would see it?

Mr. **Tomson**. It's generally fair.

The **Chairman**. Mr. Haraf, let me ask you this. Let's think the unthinkable for a minute. It's hypothetical but it has an important question attached to it.

If Citicorp were to fail, would you expect that the U.S. Government would honor its insurance claims for all of its depositors, including the foreign depositors?

Mr. HARAF. Mr. Chairman, I'm glad you asked this question. I think it's absolutely critical. But the question is really not what should happen if Citicorp fails. The right question is what should be our policy toward institutions of all sizes with respect to the protection of deposits?

I think it has been a terrible mistake to extend the reach of the deposit insurance system to large depositors, overseas depositors, other creditors, and so forth. By extending the reach of the deposit insurance system in that way we are taking a very important component of market discipline out of the system.

One of the most important pieces of advice I could give the FDIC today is that it should be developing policies to implement the reorganization of a large bank without having to protect large depositors, and without having to protect foreign depositors.

The CHAIRMAN. That's an interesting point and that's a forthright answer in terms of what you think the policy ought to be and that is that we would not insure deposits above the $100,000. I presume that you would nevertheless insure deposits of foreign depositors up to $100,000, would you not?

Mr. HARAF. Not overseas, no, Mr. Chairman, I would not.

The CHAIRMAN. Wouldn't you assume today that foreign depositors feel that they are covered by the deposit insurance?

Mr. HARAF. Mr. Chairman, today the policies of the FDIC are very ambiguous with respect to the treatment of large banks. Mr. Seidman, the Chairman of the FDIC, has been absolutely unwilling to make his position clear as to whether foreign deposits are covered and whether large deposits are covered.

The CHAIRMAN. Do you think, if in fact we were to have a national policy where we did insure foreign deposits at least up to $100,000, should we also then collect deposit insurance premiums on those deposits?

Mr. HARAF. I would think that would be reasonable, but I do not think it would be good policy to extend protection to foreign deposits.

The CHAIRMAN. Do either of you gentlemen want to comment on that?

Mr. RIDEOUT. I would just comment, Mr. Chairman, that this whole question of deposit insurance reform is a very, very important one in terms of the long-term stability and vitality of our banking industry and our financial services system.

I think the planned study is a critical one because I think important questions have to be asked. I think the first question that has to be asked is, what is it that we want the deposit insurance system to do? For instance, do we want it to insure foreign deposits or don't we want it to insure foreign deposits?

The second set of questions in a study like that need to be how do we want it to be applied; and the third question would be how do we want to finance it?

That's why we think this study is so important, to get at all those elements and really see where we want to go into the next century with our deposit insurance system.

The CHAIRMAN. I'm going to go to Senator Garn. Mr. Tomson, did you want to add a thought?

Mr. TOMSON. Only that in two speeches in November, Chairman Seidman made it very clear that the too big to fail policy is the policy of this Government and I think it's very clear when you look at the record, look at Continental, look at Republic National, look at First City—what is it that's going on regarding these banks? The policy is established.

The CHAIRMAN. Senator Garn.

Senator GARN. Let me follow on on that. There's a difference between being too big to fail and the second issue, which is whether you take care of the over $100,000 depositor. I don't know that the FDIC has said anything about that. Those are two different issues.

I also think you have to look at what you are talking about, when you say, "too big to fail." With Continental, you're talking about literally hundreds of correspondent banks, and credit unions, community banks around the country. If Continental had not been saved, they would have gone down the tube.

So I think we have to be fair about separating the issues—whether you insure over $100,000 and whether the institution is too big to fail, and when you say, too big to fail, do you mean just Citicorp, or do you mean Continental as well? I looked at that Continental case very, very closely and it's easy to say off the top of your head, well, if Continental was dumb, fine, let them fail. And I sort of had that attitude—who cares about Continental?—until I looked at the extent of the network with all the small credit unions and small correspondent banks that would have gone down the tube with them—community banks like yours.

TOO BIG TO FAIL

Mr. TOMSON. I think the systemic risk aspect of that is very important to consider and you might look at the fact that we do have to protect the payment system of the country and perhaps FDIC coverage could even be modified to consider protection of interbank deposits in some way. That would have made a different case out of the Continental had they been able to avoid the systemic risk that was involved there.

Senator GARN. I think that's incredibly important. I can remember the Chairman of the Federal Reserve calling me and asking me to call other banks' perhaps big customers at the time, and say, please do not withdraw your deposits. Rumors were going around about other banks and I can see that that, although it's easy to criticize the individual mechanisms by which Continental was saved, there was at least in my mind an incredible systemic risk at that time. When I get a call from Paul Volcker saying, "Look, will you call a few of these people with me to say, hey, settle down," I'll guarantee you, at least in my mind, that there was a need to settle it down at that time or you could have had it spread to other large institutions and the whole thing might have collapsed.

Mr. TOMSON. Chairman Seidman has said, "Come up with a better policy and we'll consider it," and I guess we aren't suggesting that the policy be changed but we're suggesting that you ought to consider what premium cost ought to go along with that, if they shouldn't in fact pay a premium for it.

Senator GARN. That's the same thing we're trying to do right now—the President, Chairman Riegle and I, at every opportunity—to assure people that their money is safe, because despite all of that, you've still got a silent run going on in the S&L's which compounds the problem that we are trying to address.

The second issue is, do you insure over $100,000? In my opinion, no. I think people ought to know loudly and clearly that they should not expect it. I think it does add to the risk and it takes away market discipline, as Mr. Haraf has said. That's why I wanted to make the point that there are two different policies: whether you save the system or whether or not you insure people who have more than $100,000, and I think the dispositors understand that if they deposit more than $100,000 that it's at risk. I don't think we have an obligation—when I say we—the insurance funds—to insure that additional risk. In fact, I recognize what you say and I was part of raising the deposit insurance to $100,000 and politically I wouldn't go back and try to change that. But in hindsight, if I could go back, knowing what I know now, it wouldn't have been raised to $100,000. That was a mistake. I and the Congress were a part of that. Because I think we added to some of the go-go operators that said:

> Hey, I can do anything I want. My depositors are protected at least to $100,000 and then if we extend it beyond that to those who are not insured, I think that no matter how stiff the regulation is, we can encourage people to take risks that they otherwise would not have taken.

So I just wanted to make sure that people understood that there are two different issues there involved and I've got a different position on each one. I think we've got to save the system. Second, I don't think we have to save those who have money in banks or savings and loans, over the insured amount because I think that compounds the problem.

Mr. TOMSON. Coming from a Midwestern State where we had 41 banks that were closed and the numbers perhaps weren't as bad in Nebraska or Kansas—Oklahoma was bad—but there were losses in our States to people that had over $100,000—not very many because most of the banks were absorbed, but there were a few cases where banks were closed and people with over $100,000 did in fact lose money. So I understand what you're saying.

Senator GARN. There have been some instances. I wish I had the problem of worrying about an account over $100,000. I'd be glad to have it at risk.

Mr. HARAF. Senator, since Mr. Tomson had a second chance, may I have a second chance?

Senator GARN. Go ahead.

Mr. HARAF. When Continental Illinois failed, arguably there was a threat to the safety and soundness of the system as a whole. A bank of that size had never failed before. There was great uncertainty about whether or not deposits would be protected, including the deposits in correspondent banks.

It's unconscionable that since the Continental failure, the Federal Reserve and the FDIC have not developed a plan for dealing with the failure of a large institution that people understand and that does not involve the protection of uninsured deposits. If such a plan were on the table, if market participants clearly understood their funds were at risk, including the funds of correspondent banks, the system as a whole would work much better. Banks, when establishing their correspondent relationships, would then have incentives to make sure that exposure to any one bank would be limited. They would also have an incentive to assess the soundness of institutions that they extend credit to. This would be an important source of marked discipline.

I might also add that the Depository Institutions Affiliation Act, which you cosponsored, provides a mechanism for dealing with large institutions. No bank is too big to reorganize. According to the Depository Institutions Affiliations Act, as soon as a bank's capital falls below standard, its holding company must provide new capital to that bank or divest it. While the bank is being divested, it would operate under the conservatorship of the FDIC.

That bill more than anything else solves the "too big to fail" problem.

Senator GARN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Following up on the insured deposits of foreigners here, let's suppose that there's a money broker in London or Frankfurt and he's assembling blocks of money to be sent over here to one of the money center banks in $100,000 denominations, as goes on everywhere. Is that money insured?

FOREIGN DEPOSITS

Mr. HARAF. Absolutely.

Senator SHELBY. It's insured?

Mr. HARAF. Those are deposits within in the United States that could just as well go to Mr. Tomson's institution as any other institution.

Senator SHELBY. Well, what are you talking about then when you say that the foreign deposits are not insured?

Mr. HARAF. These are deposits held overseas.

Senator SHELBY. In their branches?

Mr. HARAF. In branches overseas.

Senator SHELBY. OK. There's a difference.

Let's get into something that's been a little sticky around here, the so-called sticker, the FDIC versus FSLIC. A lot of people have raised the point and said, look, if we put FSLIC under FDIC separate funds what kind of sticker are we going to have on the window? In other words, what kind of credibility are we going to have to show the average depositor, whether it's in the Midwest or the South or the West, whether it's large or small, that emblem there, that sticker, and some people argue that if you don't have the FDIC sticker on the savings banks or the thrifts you're going to just create another wave of failure because people aren't going to believe that credibility has been restored there.

Do you want to comment on that?

Mr. TOMSON. Well, I think things can only get better from here if we get the legislation put in place to rectify the problems of the FSLIC. I think the public certainly understands that the U.S. Government stands behind the insurance fund.

I don't personally feel that changing the name of it or putting a different sticker up is going to——

Senator SHELBY. But a lot of people have raised that issue.

Mr. TOMSON. I admit to coming to the table with the prejudice of a commercial banker, but I'm proud of the FDIC sign obviously and would have some jealousy about it.

Senator SHELBY. Would you want to share it?

Mr. TOMSON. Not particularly at this point in time. I don't see that there's such a stigma with the FSLIC sign.

Senator SHELBY. You don't see a stigma in the FSLIC sign? You'd be the only person in America that didn't see a stigma.

Mr. TOMSON. They have a problem. It's pretty obvious. It's a $100 billion problem or greater.

Senator SHELBY. But no stigma?

Mr. TOMSON. The Government is going to stand behind it and straighten it out and bring it back, which is what this legislation intends to do, is changing the name of it going to, in and of itself, be so important?

Senator SHELBY. I'm not advocating it, I'm just bringing up the subject because it has been raised before and it's something that we ought to debate and perhaps make public policy on, and I think it is something that the debate ought to be raised on.

But if you put a FSLIC sticker on my bank I'd be worried about the silent run continuing, but if I had a FDIC sticker I believe that if I were in "x" community I'd say, look who's standing behind us now.

Mr. RIDEOUT. Senator, I think maybe a way to approach this is not necessarily to give the savings and loan the FDIC sticker, but simply to change their sticker. As I understand it, under the bill their fund is going to be called SAIF, Savings Association Insurance Fund I think is what that stands for. I'm with Mr. Tomson. I think once this bill is passed and the resolution of the Congress to deal with this problem is seen by the public, putting a sticker like that on their windows should satisfy the public in terms of their concern.

We have a flipside concern. We're hearing from some of our customers questions about in fact whether the FDIC fund is going to continue to be sound and solvent and our customers do know the difference between a thrift and a bank.

Senator SHELBY. I think most people do.

Mr. RIDEOUT. That's right. And to see the FDIC sticker put on the window of a thrift which the people know could well be having problems could cause some very serious concerns in their minds about the safety and soundness of the FDIC fund.

So I think there's a way to deal with this and perhaps the way is just to put the new SAIF sticker on the window of the thrifts and that would take care of the problem.

Senator SHELBY. Do you have a comment, Mr. Haraf?

Mr. HARAF. Senator, the Financial Services Council doesn't have a position on the sticker issue.

Senator SHELBY. OK. Well, it's still sticky, but maybe we can handle it.

Mr. Chairman, thank you.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

Mr. Rideout, I'd like to follow on with the questions about imposing the premium for deposit insurance on foreign deposits and raising the question this way. I just assume that the competitive nature of the international financial markets is so great that the imposition of I guess it would be 18 basis points on those deposits would make American banks—put them in a very precarious position from the standpoint of competition internationally.

Is that a fair statement?

FOREIGN DEPOSITS AND DEPOSIT INSURANCE

Mr. RIDEOUT. I think it's a very fair statement and a very real consideration in terms of this whole issue, and I think that's the kind of question that has to be looked at closely in this study. That is to say, if in fact we apply the insurance premiums to those foreign deposits, what will be the unintended impacts of that action?

Now I'm not sitting here and saying that we shouldn't do it. I think what's important again is for us, number one, to have an approach which says that large banks and small banks and their customers should be treated alike as far as what the deposit insurance system does, and to figure out the best way to do that with an element, as Mr. Haraf indicated in his remarks, of market discipline. The ABA feels very strongly that we need to somehow introduce the concept of market discipline into the deposit insurance system.

We have a committee which is working on this, and we hope in the next month or so to have some thoughts and ideas about that, that can be useful to this study committee as this process goes forward.

Senator MACK. Let me just ask one more question with respect to this and, Mr. Tomson, I may give you a chance to take a shot at it, too.

I don't have the exact numbers or don't know the numbers of foreign deposits as a total of our deposit structure, but I would guess that from the number that you used in your testimony going from 18 basis points to 12 basis points it's a fairly significant dollar amount and I guess my concern would be, again, if those competitive forces were to force foreign deposits out of our deposit structure, that could have a significant impact on the financial structure in our country. Again, both of you or all three of you might want to respond.

Mr. RIDEOUT. There is no question that there could be a very important competitive impact in terms of our international competitiveness if the cost of foreign deposits in effect gets out of sync with the marketplace.

I think a very interesting consideration in this, Senator Mack, is in the first table in our statement. Part of the examination and consideration needs to be to compare our deposit insurance burden for our banks with those of foreign governments.

In table one we set forth some current research adjusted for the values of currency on that. For instance, just looking at Germany right now, their premium is 3 cents per $1,000 compared with the U.S. currently at about 8.5 and going up to 15 percent or 15.3 percent on a currency adjusted basis. In Japan, it's 1.2 cents, again versus 8.5 cents, 12 cents, and 15 cents as this thing is phased in. In Canada, it's about 10 cents.

So there's not only the question of assessing the premium on the foreign deposits, but there's also this broader question of what the cost of deposit insurance is in this country versus foreign countries as well. It relates to this whole question of international competitiveness. It's very important.

Senator MACK. Mr. Tomson.

Mr. TOMSON. What we're suggesting is that if you include the foreign deposits in the assessment base—and our figures show there's about $350 billion there that would come into that—that you would generate another—just at 8 cents, you would generate another $473 million annually.

Senator MACK. Can I interrupt there for just a second? I think that the calculations are probably quite accurate, but I think the argument would be that those deposits wouldn't be there to earn that income on in the first place if the reaction to a free and competitive market is the $350 million would be lost as part of the deposit base and therefore there wouldn't be any increase in the income.

Mr. TOMSON. Perhaps that might happen. Maybe you would see an exodus of those. But at the present time, they are in these banks and the policy that we have in place keeps them under the umbrella of the Government safety net and presently those banks are only paying on 38 percent of their deposit liabilities, while out in the country we're paying on 88 percent.

I am concerned about our earnings, too. Statistical review of the figures for 1988 would show that we're not getting fat out in the country, that we have problems with earnings just like we have in the large banks.

Senator MACK. Let me say this, Mr. Tomson. I am very, very sympathetic to your point of view. I don't know whether you know it or not, but I spent 16 years in the commercial banking business as the president of a small, independent bank, and so I know your concerns.

But I'm just saying I think the reality of the argument really leads one to believe that if you were to impose that fee again on a freely open and competitive international market, that those funds would most likely flow out and the earnings or the income to the funds would not in fact be generated.

Mr. TOMSON. I have no way of really having a good feel for that supposition, but perhaps they might flow into affiliates of the same holding companies. They might flow into foreign chartered banks. I doubt if they would let them escape.

But if they can demonstrate at the present time that the policy is in place, that they are under the umbrella, I think they ought to be examined and looked at and looked at closely. And whatever it is we can do to keep the costs down for all of us, I think it's worthy of examination.

Senator MACK. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cranston joined us a while back and has indicated he does not have an opening statement this morning.

Senator CRANSTON. I don't have any questions at this point either.

The CHAIRMAN. Very good. Senator Roth, did you have an opening comment that you wanted to make?

Senator ROTH. No, I don't, Mr. Chairman.

The CHAIRMAN. Senator Graham of Florida.

Senator GRAHAM. Thank you, Mr. Chairman.

Mr. Rideout, I'd like to start by commending you on your company's decision to have a greater presence in our State and wish you well.

Mr. RIDEOUT. Believe me, it's our honor and pleasure, sir. We're looking forward to an expanded role in Florida.

Senator GRAHAM. That gives me additional confidence in your judgment.

Mr. RIDEOUT. Thank you.

Senator GRAHAM. I'd like to continue the questions that Senator Mack was asking.

Do you believe that the increased premium for FDIC that is contained in the administration's proposal is actuarially justified?

INCREASED PREMIUMS

Mr. RIDEOUT. Well, Senator, I'm certainly not an actuary, but we certainly believe that it's important to get our fund back to the 1.25 percent level. As an industry, we certainly are willing to pay increased insurance premiums to do that. I suppose I could sit here and argue that it ought to take longer, that we'd rather have it stretched out to 1999 or the year 2000 and have a slightly lower level.

I think what's important is that we get there in a reasonable amount of time. We think the proposal is about on target with respect to getting there in a reasonable amount of time. And beyond that, what we think is important is once we reach that 1.25 percent level that we have in place language that allows rebate of future premiums to come back to the banks as long as the fund is maintained at the 1.25 percent level.

We are very anxious to ensure that language is written into the bill to accomplish that.

Senator GRAHAM. If this were a marketplace operation, if this were a surety bond or casualty insurance, there would be an adjustment of the premium based on some assessment of the risk and the potential cost of servicing those risks.

It was represented to the committee that an analysis analogous to that was used in establishing this premium base for FDIC. Speaking on behalf of your organizations, do you believe that that was an appropriate analysis and has it achieved its actuarial objective?

Mr. RIDEOUT. Well, frankly, I'm just not familiar with the specifics of the analysis which might have been done in Treasury or in other places to reach this judgment about the 1.25 percent level.

I would say this about the 1.25 percent level. That is, if I were chairman of the FDIC, I would have a comfort level personally if the fund was at 1.25 percent. Again, I could argue that because we're going into a phase-in period with respect to risk-based capital where our capital requirements are being increased, and if you look at capital as in effect a deductible on an insurance policy, that the higher your capital is the higher your so-called deductible is. And in that analogy perhaps the level ought to be 1.1 percent or that it ought to be 1 percent flat.

I could certainly make that argument, but again I think 1.25 percent is comfortable, generally speaking. Most of the bankers that I've talked to were comfortable with the level and whether the actuarial analysis—the methodology of it is satisfactory—I don't have enough knowledge to comment on that. We'd be more than happy to file a comment for the record if that would be helpful to you.

Senator GRAHAM. I would be interested in that. Then to bridge over to the question of the foreign deposits, if that is actuarially sound to cover the deposits that are legally insured, is it also actuarially sound to insure those that have been given the de facto insurance represented by Mr. Seidman?

Mr. RIDEOUT. Going over into the too big to fail issue and take on the other deposits and the other liabilities?

Senator GRAHAM. Yes.

Mr. RIDEOUT. We'd be more than happy to do some work on that and try to get a written response back to you.

Mr. TOMSON. In looking at assessing premium, of course, the private sector will segment the market and assess their premiums based on risk, and I hate to sound like I'm pointing my finger at one segment of the market, the large banks here all the time, but when you look at what losses the FDIC has sustained in the last year you have to include First Republic and First City and Amcorp and the large ones. We closed 41 banks in Iowa in a period of 2½ years and I asked the superintendent of banking recently and also one of the officials at the FDIC what the total cost to the FDIC was in that, and they estimate that it was less than a quarter of a billion dollars in total cost.

So the risk was spread obviously among a number of smaller institutions and the hits weren't as great as they are when you get involved with one major size loss.

Senator GRAHAM. I introduced some legislation relative to the savings and loan industry to give authority to the insurance fund to develop variations of premiums based on that segregation of risk concept.

Would you have any comments as to whether you think that's a good authority for a government deposit insurance fund to have and, if so, should it be applicable to the commercial banks deposit insurance fund as well as to the S&Ls?

Mr. TOMSON. Well, it certainly has merit and should be explored. I am not prepared to sit here and come up with any analytics that we could throw out, but I would think we would have to endorse that type of endeavor, yes.

Mr. RIDEOUT. Senator, I think it's correct to say that not only is the banking industry beginning to be put under a risk-based capital setup, but the same is true for the savings and loan industry.

Our industry feels very strongly that risk-related or risk-based insurance premiums is an idea that needs to be explored and needs to be implemented, and we think that that should apply to thrifts and to banks as well. We would like to work very closely with you and with the FDIC and others to figure out a way to do that. It's not easy. It's a complex matter, but we think it's something that can be worked out, and we would endorse it.

Mr. HARAF. Senator, permit me to address the matter of the actuarially sound size of the fund and actuarially sound premiums. If you were in the fire insurance business, the actuarially sound premium you would charge would depend not only on the quality of the houses you were insuring, whether they were made of wood or brick, but also on how good the fire department was in that location. Certainly there's a very apt analogy to be drawn here. So long as bank regulators operate on the principle of timely intervention, and so long as they make sure that as soon as capital standards are violated actions are taken to bring capital back up, the actuarially sound premium can be very low because losses to the fund would be minimal.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Graham.

Senator Pressler.

Senator PRESSLER. Thank you, Mr. Chairman.

Let me direct this question to anyone. Commercial banks as well as thrifts accept brokered deposits. Do you believe there should be limitations on this activity? If so, what should it be? Are the brokered deposits insured and who is covered by the insurance and who assures that it is bona fide?

BROKERED DEPOSITS

Mr. TOMSON. I'll start on that. We have felt for some time that brokered deposits need to be examined more closely. I have talked with my Congressman about them. He said, "Well, perhaps you're treating the symptom rather than the disease," and I said, "Well, I wonder if we aren't looking more at the virus that's causing the disease rather than just the symptom."

There certainly have been some significant amount of abuses connected with deployment of brokered deposits throughout the country and I think the statistics on bank failures, both FDIC and the FSLIC, would show some significant amount of that type of liability in perhaps most of the institutions that have gone down.

Senator PRESSLER. Generally speaking, the Independent Bankers would not get very many brokered accounts, is that true?

Mr. TOMSON. No. There are some that might use them periodically for seasonal purposes and I don't believe that you can just say they're entirely categorically bad. But I wonder if there are some mechanisms that could be put in place to place them better. The FDIC will be asking I understand for a display of them in the call reports, number one. Perhaps they could pay a higher premium on brokered deposits. Perhaps you could subject them to a higher reserve requirement. Perhaps in the risk-based capital provisions that are being put in place you could require a higher capital base for the employment of volatile liabilities in your balance sheet. I think there are a number of remedies that could be put in place if you don't want to just throw them out altogether that would make them a little less attractive to use.

Another thing on brokered deposits, of course, the interest is guaranteed as well as the principal. I can see several ways in which they could be slowed down certainly.

Mr. **Rideout**. Senator, I think it's important with respect to brokered deposits not to have an attitude that they are terrible and that they ought to be totally outlawed.

Brokered deposits are a source of funds and a legitimate source of funds for many different kinds of financial institutions, and I think it's important to keep that in mind.

Having said that, there is no question that brokered deposits have been abused by institutions that were insolvent or were nearly insolvent, and I think the real key with respect to the whole brokered deposit question really comes back to the need to have rigorous and equal capital standards for banks and for savings and loans and, secondly, to have rigorous supervision and examination authorities in place to ensure in fact that the banks are meeting those standards and that they are being accounted for properly.

I think essentially the brokered deposits issue is one which can be handled very easily by the regulators if we have in place the kind of regulatory regime and authority that we need. We think this bill provides the kind of authority that's needed to in effect equalize for the S&L's their capital and their regulation and their supervision with that of the banking industry. So we think the brokered deposit problem, to the extent it is a problem, can be dealt with by the regulators very effectively. So we would caution against anything being put into law that says, "Thou shalt not use brokered deposits" or "Thou shalt not use brokered deposits above some particular threshold or level."

Mr. **Haraf**. Senator, we would agree with Mr. Rideout. Treating brokered deposits is treating the symptom. The perceived problem with brokered deposits came about because some insolvent and weak institutions used those deposits to try to grow their way out of problems. I think you should go after the source of the problem and not the brokered deposits themselves.

Senator **Pressler**. Now let me ask each of you this. Generally speaking, do you think we should devise some limitation on insurance of individual accounts? For example, a wealthy grandfather might have separate insured accounts in one institution in trust for six or seven grandchildren. I'm not saying there's anything wrong with that. But is the law being essentially circumvented in some cases or is there a need for us to do some work on that?

Mr. **Tomson**. I don't know just how to respond to that. I feel that the levels as they presently exist don't display too much abuse. There certainly are people who bank with more than one institution. I think it would be difficult to police. Maybe you would resort to using social security numbers or something like that. And you're suggesting you might have some absolute dollar limit that would be available to a citizen and that would be it.

We have a very diverse economy. Between banks, S&L's, credit unions, we have maybe 30,000 or more financial institutions that are out there operating. Competition has always been a strong part of the way we do business in this country and I think it might affect the competitive flavor more than what you'd like to see in the marketplace.

Senator **Pressler**. We've had great frustration in the farm bill with the $50,000 limitation. Suddenly some of our farmers have become the greatest corporate lawyers in the country to qualify for more units or something.

Let me ask you this. The Independent Bankers strongly favor assessing the large banks for their foreign deposits and other nondeposit liabilities. What is the view of the ABA in this respect?

Mr. **Rideout**. With respect to the foreign deposits?

Senator **Pressler**. Yes.

Mr. **Rideout**. We think that it's clear that in terms of practice that large institutions and smaller institutions have not been treated equally, and we think one of the goals of the deposit insurance reform study which is contemplated in this bill would be to treat them equally.

We do not have a position at this point in time with respect to whether we should assess foreign deposits. We think, however, it's an issue that needs to be examined in the context of the broader question of what we want the deposit insurance system to accomplish.

Senator **Pressler**. But you're here testifying and I know that you're looking at it, but what is your view? The Independent Bankers say they strongly favor assessing the large banks for the foreign deposits and other nondeposit liabilities. What is your view?

Mr. **Rideout**. Our view would be that this particular bill should not be burdened with that particular question, that the issue should be examined in the context of the broader reform of the deposit insurance system in the study, and we would certainly in that process as a trade association be willing to provide our comments about what the deposit insurance system ought to do and how it ought to be financed. In other words, whether in fact we should think about——

Senator **Pressler**. But the Independent Bankers feel it should be a part of this exercise.

Mr. **Tomson**. Yes, definitely, very definitely.

Senator **Pressler**. All right. Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Pressler.

Senator Bryan.

Senator **Bryan**. Thank you very much, Mr. Chairman.

Mr. Rideout, let me ask you a question about philosophy and perhaps position, if any, that the American Bankers Association has taken.

That is, is it the view of the association that the savings and loan as we know it today—does it have a viable role in the future as an independent institution?

FUTURE ROLE OF S&L'S AS A VIABLE INDEPENDENT INSTITUTION

Mr. **Rideout**. We feel there is a future, Senator. I think it's contemplated certainly in the bill, and I think Secretary Brady has testified to this, that there's nothing inherent or intended in this bill to do away with the S&L industry. I think the S&L industry over time has provided valuable service to the American public in terms of the kinds of financing it's provided, and we certainly don't feel at all that the S&L industry should go away or necessarily will go away.

Again, one of the misimpressions we think that's being presented around the Hill is that somehow if S&L's do not meet the capital standards by June 1991 that they're going to automatically go out of business. We think this is totally fallacious. What we think will happen and what we think should happen to S&L's that haven't met that standard is that they should have to do what banks have to do at this point in time, which is to sit down with their regulator and work out a supervisory agreement that will get them to their appropriate level of capital. That sort of plan could include a number of elements, such as limiting growth, limiting dividends, controlling expenses, and putting limits on various kinds of lending to help them get to that point in time.

We think the bill will in fact allow a reasonably solid and healthy S&L industry to continue to exist and we think that's fine. We have no objection to it.

Senator BRYAN. What's the objection to the argument that's been advanced to provide a little more flexibility, rather than having that 2-year period of time, as you know, we heard testimony yesterday from the industry asking for 5 years. Is there any great vice in providing a structure in this bill to say we'll give you a little bit more flexibility as long as there's incremental progress, that is that you're making progress towards attaining the 6 percent capital requirement?

Mr. RIDEOUT. We think very simply that the flexibility, if there is any, should be given to the regulator, that the regulators can work that out. That's what they do with us today. For instance, if a bank today—if my bank were to take a big loss on some loans and be below the capital standards, our regulators would sit down with us and we would put together a plan to get back to our minimum stated regulatory capital. We don't think there's any reason why the same kind of discipline and approach shouldn't apply to the S&L's as well. Once we get to June 1991, there could be any number of institutions that don't make the target. The regulators then can sit down and work out a plan with them and hopefully put in place a plan that will get them to their target.

If the health of the institution is such that a viable plan cannot be put in place to get them to their capital targets, then obviously the institution will need to be sold or need to be merged or whatever, and that's just part of what goes on in the marketplace. It happens with us today. There's no reason why it shouldn't happen with the S&L's. They're getting in effect a 2-year ride. We have to deal with that today. They're getting that 2-year ride, and they're getting some other concessions. I think it's important to recognize that with respect to, for instance, the amortization of good will, that they will have 10 years to amortize down their good will. And I think it's also important to recognize that in the risk-based capital formula that the weighting for mortgages, which is what the S&L's really concentrate on, is much less than it is for other kinds of lending. So that their basic capital target and standard will be a little bit less probably than that of a typical commercial bank.

So we think there's plenty of room in there for this thing to be accommodated.

Mr. **Haraf**. Senator, the lesson of the 1970's was that forbearance on capital standards was a terrible mistake. The Financial Services Council supports the idea that we need to strengthen capital standards within the savings and loan industry and that the June 1991 timetable is reasonable provided that there is proper encouragement given to the private sector to help in the process. A savings and loan that does not meet the new capital standards by that date should fall under growth restrictions and other supervisory constraints.

Senator **Bryan**. So it's your interpretation or reading of the bill that the 1991 deadline is not a draconian deadline but one that provides sufficient flexibility for the regulator to say, well, you haven't met your capital requirements but we're going to work with you and design a plan, if viable or feasible, to obtain that goal over a period of time in the future. Is that your understanding of the bill?

Mr. **Haraf**. Yes, sir.

Senator **Bryan**. One other question that I had was if we adopted this bill as is, no changes, how many of the 3200 S&L's do you think would be around 5 or 10 years down the road?

Mr. **Rideout**. That's a highly speculative question. That would be very difficult. I really can't answer the question because you have to make all sorts of assumptions about what interest rates are going to do and that kind of thing; and none of us really knows what the answers to those questions are.

It's clear that there are a number of insolvent institutions today that need to be dealt with. That's why it's important that this bill be passed and passed into law as quickly as possible. And it's clear that there's another group—and I'm not sure how large it is—of undercapitalized institutions that are heading towards insolvency, and if interest rates continue to rise that may accelerate that phenomenon. That's why we think it's important to expand the ability of bank holding companies to acquire not only the failed but those that are in the process of failing so that additional capital and additional bank management expertise can be brought to bear to keep those institutions functioning and working well in the future.

Senator **Bryan**. My time has expired, Mr. Chairman.

The Chairman. Thank you, Senator Bryan.

Senator Roth.

Senator **Roth**. Thank you, Mr. Chairman.

If you would deny the FDIC sticker to the S&L industry, would you accept an alternative sticker, something that said, for example, "insured by an agency of the U.S. Government," which would raise confidence in the S&L's?

Mr. **Tomson**. I don't object to that, Senator. I feel whatever can be done to restore stability and in the interest of safety and soundness should be done. We just advocate that it be different than the FDIC sticker, which we have.

Mr. **Rideout**. I would concur with Mr. Tomson's comments.

Senator **Roth**. If the Government wishes that banks would buy unhealthy thrifts, wouldn't it undercut that policy to allow them to buy healthy thrifts as well?

CONSOLIDATION OF FINANCIAL RESOURCES

Mr. TOMSON. We have stood in opposition to the acquisition of healthy thrifts by banks basically because we don't want to see the continued consolidation of financial resources go on unabated in this country. I think there's value in diversity and that changing this would not serve that purpose well.

Mr. RIDEOUT. I think, Senator, it's really just a question of trying to ensure that we get additional capital where we need it, and I think the administration's plan proposes a 2-year waiting period in effect for the acquisition of healthy thrifts so that the failed and perhaps the failing thrifts can be acquired.

We understand all that, but our sense is that it probably would be well in the long run to go ahead and accelerate the ability of banks to put money into and/or acquire healthy institutions just so we can move forward with the program and in effect have capital flowing into the markets where it needs to flow.

For instance, you may have a situation in a market which is one that's losing population where there are two or three either insolvent or failing savings and loan associations and the fact is that those associations just may never be sold because there is no buyer, nobody who really wants to go into that particular marketplace. That's why I think it's important just to open the thing up as quickly as we can so that the marketplace itself can determine where we need to have institutions and where we don't need to have institutions. In other words, some markets are overbanked and some markets are underbanked, and what I think the process will do is to allow all of that to be worked out in a marketplace kind of approach rather than just artificially saying you can only bid on this particular group of institutions because you may well find that you don't have any interest in them anyway and while you're waiting on all of that you're not allowing the system to work on those perhaps that are failing or could fail, that could in fact could be bought and could be turned around and made very efficient and very competitive.

So I think we just tend to be more for a let's open it up kind of approach with respect to the S&L's.

Senator ROTH. We had the U.S. League before us yesterday and they testified that there were certain activities authorized by the States that were so risky that they felt they should be federally prohibited.

Do you agree? Does this comport with the dual banking system?

Mr. TOMSON. Well, maybe I can reflect back on my days as a Federal Reserve bank examiner. I examined banks for the Federal Reserve Bank of Chicago, all State-chartered banks, for a period of 6 years, and any commercial bank that wants to be a member of the Federal Reserve has to submit to certain rules and regulations and statutes of the Federal statutes in order to enjoy membership. And the same is somewhat true of nonmember banks but to a lesser degree.

For example, section 5136, U.S. Revised Statute, governs the manner in which a national bank can handle its investments securities portfolio. A State bank that wants to be a member of the Fed has to abide by the same statute. Regulation O in section 23(a) of the act, loans to affiliates and reporting of loans from other banks and so forth. There are many instances where State-chartered institutions come under the purview of both Federal statute and Federal regulation, and I think this could be examined more closely and I don't feel—in fact I can't recall in those 6 years that I had any experience with CEO's of State banks where they were complaining bitterly about the manner in which they had to comply with Federal law.

So there certainly is a pattern out there that we can look to and say if you want to be a member of the Federal Reserve or if you want to have insurance, as we're talking about here, that you would have to subscribe to these rules and regulations and they may not be completely in keeping with your own charter privileges. If they are more restrictive, so be it, if they want the insurance.

Mr. RIDEOUT. Senator, I would comment that I think it's awfully important in this process that we work to keep the dual banking system intact. Just speaking about banks at this point in time, I think it's very clear that over the years that the dual system has encouraged a lot of innovation, a lot of experimentation that has brought new products and services of a financial nature to the American public.

For instance, checking accounts, the trust services, NOW accounts, things like interstate banking that are now going on occurred because of State initiatives. I think it's very important that we recognize that and that we continue to encourage that kind of a system.

I think it's also important to recognize that the FDIC as the dual regulator or dual supervisor of State-chartered banks, along with the State banking authorities, has in effect ensured that no abuses with respect to state authorizations have taken place.

In other words, I do not know of any instance where a State-chartered bank failed because it abused some authorities that were put in place as a result of State law. I think the reason for that is very simple. The reason is that the Federal Deposit Insurance Corporation has sufficient regulatory power and has utilized that power sufficiently over the years to assure that there have been no or very limited abuses with respect to all of that. And I think that same theme can carry over with respect to the regulation of State-chartered thrifts.

Senator ROTH. What about S&L's abusing State powers?

Mr. RIDEOUT. Well, I would just say very simply this, that if an S&L abuses a State power, then the regulators need to move in. I think this bill certainly contemplates an ability perhaps on the part of the FDIC to deny insurance if someone is abusing power or if States are passing laws that, for instance, say that you can invest all of your capital in this particular kind of a loan or this particular kind of an enterprise. I think the regulators need to have the authority to crack down on that, but I think what we need to be careful about in all of this is to allow banks and allow thrifts to serve the marketplace. And if State governments are saying, for instance, as many of them are saying today with respect to State-chartered banks, that you may get into the business of agency services with respect to insurance—we just saw an initiative passed in

California last fall in that regard—and we can bring more competitive insurance services and a more competitive climate with respect to insurance to the consumers out there, that the consumers benefit from that kind of thing. The important thing is that it be regulated properly.

The CHAIRMAN. I wonder, Senator Roth, if you would yield to me at that point. I want to make an observation on this.

I want to take strong exception to what you said. I feel very strongly that we've got an awfully large amount of evidence in front of us that there are some major holes in the logic that you just expressed.

When you look at the failure rates of the savings and loans, we're asking the American people right now to step up and have to pay for most of the cost of at least $100 billion failure, and you're in here endorsing that plan today. You are endorsing the fact that they in fact pick up that part of the cost. That's an inescapable reality.

When you look at where the predominant amount of the losses took place, they took place in States, in State-chartered institutions, with powers that went way beyond what the Federal Government allowed. The regulatory system did not get the job done. And I think when we're not even through the problem, to just say flatly that a regulatory system by itself is adequate to do the job when we're here because we've got the biggest financial disaster we've ever faced because it didn't do the job is just not very plausible. You can believe it, but when you're sitting here joining in a chorus asking the American taxpayers to probably pay at least $75 billion here because precisely that system did not work, I think really tests your own credibility.

The fact that we have not had substantial losses yet—and I say yet—in the commercial banking system because of the use of State powers in other areas, I would hope that we would not in the future, doesn't guarantee that we won't in the future. Nor do we have any guarantees that the regulators that we have in the future or even the economic conditions that can come along and test these systems in severe ways, that we have necessarily seen the full range of conditions that can come.

So, I find it very difficult when I hear casual comments about the degree to which States should be allowed to offer these expansive powers, they don't want to provide the insurance. They don't want to provide it. They want the powers but they don't want to provide the insurance. They want the Federal Government to provide the insurance. Why shouldn't the States provide the insurance if they want to add powers? Why shouldn't they provide the insurance?

Mr. RIDEOUT. I would be more than happy to respond. I hope you don't think, Senator, that I have a casual attitude or that our association has a casual attitude about this problem at all because certainly there have been abuses with respect to the savings and loan industry and some of these State powers. There's no question about it.

And there's no question either that the regulatory system that was in place was not properly prepared to deal with those abuses.

I think what we're trying to suggest is that, No. 1, with respect to the dual banking system, that it's been a very valuable, important part of our banking system for a long, long time. We would like to see that continue.

The Chairman. Let me just ask you this specific question because you haven't responded to this. If the States want to add additional powers, why shouldn't they take the responsibility to provide the insurance for those additional powers?

Mr. Rideout. Well, I think there really are two responses to that. First of all, we have had a State system to some extent in place—States like Ohio and Maryland I think had systems of that kind in place and they did not work very well. And I think what you come around to ultimately in answer to your question is to say if there's going to be Federal insurance of those institutions that have those activities, the Federal insurer—in this case the FDIC—has to have some authority to deny insurance to associations who are carrying on things that are not safe or not sound or they have to have other ways to deal with them. They have to say, for instance, Senator, that we don't like that activity and we want that activity out of the bank.

The Chairman. Well, sometimes that happens and sometimes it doesn't. Sometimes you get a competent regulator and sometimes you don't. Sometimes ideology takes over, sometimes it doesn't. We're sitting here in the middle of a $100 billion disaster and I think it's inescapable that that was a major part of the problem in terms of State powers being added. Last year, 59 percent of the total losses in the savings and loan system occurred in two States—Texas, which was half, and 9 percentage points in California. I think we're going to need to discuss this, but I think you folks need to take a closer look at that problem, and if you don't, I think it would be a serious mistake. I don't want to trespass on the time of Senator Bond.

Mr. Rideout. Senator, we understand how you feel about it and we recognize——

The Chairman. I don't think I'm the only one that feels that way I might say.

Mr. Rideout. And we certainly recognize that it's a complex problem. We would like to work with you and I think there is a solution to deal with that particular problem.

The Chairman. Well, I don't think the solution is more of the same. I don't think we want to hear the same record over and over again. This problem is big enough, it's serious enough, and it's threatening to your own business enough that I think you're going to have to do more thinking on how we eliminate the risk of that problem coming in from that direction in the future.

Mr. Rideout. We'll be pleased to do that and look forward to working with you.

Senator Roth. Mr. Haraf, I think you had a comment?

Mr. Haraf. Thank you, Senator Roth. The Council shares the view that outright prohibitions on activities at the State level would be a mistake. Instead, regulators shall have the power to deal with specific instances of abuse, as Senator Roth suggested, through cease and desist orders and other mechanisms. Of course, the Council's position is that organizations should be permitted to engage in a full range of financial services activities, within separately capitalized subsidiaries. This position has been endorsed by the FDIC in its proposal, *Mandate for Change*.

The States have played a positive role over the years by permitting innovations to the system that have been positive and useful. It would be a terrible mistake to shut down that activity entirely.

The CHAIRMAN. Senator Bond.

Senator BOND. Mr. Chairman, thank you.

I appreciate what Mr. Haraf said and I would like to come back at another point and revisit the question of the dual banking system because I do think there are advantages to it and I think we need to have safeguards.

We have seen in this S&L mess that it doesn't matter who gives the powers when you have lousy regulation and inadequate supervision. You can wind up in the tank regardless of who granted the powers and there's plenty of blame to go around on that.

What I'd like to do now is to move to some questions I have about the enforcement provisions because I think they are extremely important as we look down the road to the future.

Mr. Tomson, I'd start off with you. I was interested in your comments on the enforcement provisions. You cite the example of the $25,000 fine for a late call report or actually it says it's up to $25,000. Would your concerns be assuaged if there were language in the bill making fines applicable only in cases where there was a reckless, willful violation or a repeat violation?

ENFORCEMENT PROVISIONS

Mr. TOMSON. That would help a great deal. I think if there is a reckless or a willful intent to not comply, that goes a long way in helping it out.

But I feel to leave a decision to—you know, the arbitrary decision of the regulator, and if it is not a willful violation, if it is just an inadvertent violation, I think that would be, you know, a gross miscarriage of justice.

For example, for a call report. You submit it, and assuming you have submitted it and you think it is there and it is proper and you come back and you find that there is something improper, there may be some dispute over the way it has been displayed, they get fined for an unwillful violation or an unintentional, and I think it would be wrong.

Senator BOND. Well, I agree with you that the penalty seems a bit harsh in a situation of a simple mistake. But clearly we need to have some means of imposing severe penalties where there is deliberate deception, crooked individuals who get control of a financial institution, and where there need to be some effective penalties.

I would welcome any language that you or the other members of the panel can submit to us on that.

Mr. RIDEOUT. We would like very much to work with you on that. We think there are some real potential abuses of due process that exist as a result of the way the bill is written right now.

I would give you an analogy that it might be helpful—say, you get a parking ticket and were not able to put money in the parking meter because the meter was broken but yet you are fined $1,000 a day by the local city. The potential for that kind of abuse exists in this, and we really want to make sure, that criminal type activities are indeed prosecuted and that there are ample penalties with respect to those.

But where there are issues of honest disagreement we think it is improper for, for instance, an examiner on the site to have the ability to just come in and start assessing fines because he disagrees with management on, for instance, the kind of information that went into a call report, and to start assessing $25,000 a day fines for that we think is potentially quite abusive.

So it is a very fine kind of line that we need to work out, and we would like to work with you on that.

Senator BOND. Mr. Haraf, do you have comments on that?

Mr. HARAF. Yes, Senator. The bill introduced yesterday by Senators Cranston, D'Amato, and Garn, the Depository Institutions Affiliation Act, also emphasizes strict enforcement and penalties. The Council would be happy to provide a comparison of the enforcement provisions of the Depository Institutions Affiliation Act with those contained in S. 413.

There are some significant areas in which the DIAA's provisions are even more strict than those contained in S. 413. However, certain provisions of S. 413 raise some concerns.

Senator BOND. What other areas are there of concern, then, besides the fine on the late call report? What other things do you think in S. 413 are bad, overreaching, unworkable?

Mr. HARAF. Senator, the Council would have to study the bill more carefully before we could answer that. I would be happy to provide you with an answer in writing.

Senator BOND. Mr. Tomson.

Mr. TOMSON. The bill, title IX, greatly expands the power of the regulators to use cease and desist orders, and we would like to have a little time to take a look at that and perhaps expand on it or get back to you on it.

Also, the enforcement targets to institution-related parties seems pretty severe, and I think this could have, you know, a serious chilling effect on potential investors.

Senator BOND. But, boy, I tell you, we are going to go after the people who run out the door just before the roof falls in. We are going to do something about them, and if you want to clean it up or polish it up, that is fine, but if I have anything to say about that, those tools are going to be in there because we have seen too many guys——

Mr. TOMSON. I understand, and we appreciate that.

I am involved, for example, in the ownership of three commercial banks. Two are in Iowa and one is in Minnesota. I own 52 percent of the stock in one, 60 in one, and 70 in one, and I am very happy to have the minority shareholders in there with me. I need their capital and their interest and their equity, and I need good boards of directors, and I need people who are willing to serve who represent the cross-section of these communities, and when it becomes apparent to them that they are kind of in a no-win situation, they are very reluctant to serve.

And I believe that if community banks are going to represent a cross-section of the communities in terms of their directors, and so forth, that we have to give some consideration to the difficulty that it is to get people to serve as investors and directors and shareholders in these institutions, and that is what I am suggesting.

Mr. **Rideout**. Senator Bond, we had a call from a banker just yesterday at ABA's offices who had just become aware of this enforcement title and he had read the language, and he said there isn't any way that I could get anyone in his community to serve as a director of his organization if that language is in place.

Our legal staff and our regulatory staff is looking at this whole title, and we will have an analysis of it. We would like very much to work with you and see if we can't work out language that will strike a more reasonable balance with respect to enforcement, but still be strong and tough where it needs to be strong and tough.

Senator **Bond**. Thank you, gentlemen. We are sympathetic to the questions you raised about not discouraging good people from serving, but there has got to be something in there for when you get ripped off. Maybe one of your minority shareholders decides that he really likes life in Brazil, we need to catch him before he gets across the border.

Mr. **Rideout**. We are with you on that, Senator.

Mr. **Tomson**. Senator, one aspect of this is capital, and I think as you get institutions more highly capitalized and you have people in these communities that have money at risk, significant money, you will find that they pay attention closer to what their investments are doing for them, and perhaps that is one of the aspects of the thrift debacle, that there hasn't been enough commitment from the people who are involved in the management of these in terms of equity ownership.

And I think part of this will resolve itself as you insist on higher capital ratios for insured institutions.

Senator **Bond**. The best authority for that is the Bible, to go back to the admonition that wherever man's treasure is you will also find his heart. [Laughter.]

Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Bond.

You know, it is interesting a lot of what we are hearing at the moment is let's have good tough regulation, let's have more regulation, let's have good regulators, let's really count on the system of regulation. This often happens when we are in the middle of a crisis and a lot of money has disappeared.

But what happens is that after we come in and fix the problem then everybody comes in and complains about the regulators. There are too many regulators, the regulators are doing this, they are doing that. There is a general drum-beat to basically ease the regulatory burden, deregulate, and back off the regulators.

In watching these ebbs and flows over now two decades plus here in the Congress, I think our role is to set in place a legal framework where we put some outer bounds in places that are sensible, especially when Federal deposit insurance is connected to it. We have got the taxpayer on the line, as we are finding painfully here in the case of the savings and loan situation. When we have that situation, we can't rely on regulators coming and going and the ebbs and flows and the fact that, frankly, your organizations blow hot and cold on regulation.

I don't just aim that at you. It is virtually the same for all the witnesses we hear.

I want to make sure this time around, when we are having to eat a $100 billion problem, that we are able to give ourselves some assurance that we have put together a structure of law and a set of boundaries in place that are prudent and will work.

It is obvious that while we thought we had that in the past with the savings and loan industry, it turned out we really didn't have it. Now, we have got a $100 billion headache and, as I say, I have made it very clear how I feel about the State powers add ons. I am not going to rehash that now, but I think anybody that wants to let States go off and do that and ask the Federal taxpayer to pick up the tab has an unsustainable argument.

Senator Heinz has come in. I don't know, Senator Heinz, would you want to at this point maybe make your comments or ask your questions, or would you rather I go to Senator Shelby and come back to you?

Senator HEINZ. If you are calling on me to ask questions, I would be prepared to do so.

The CHAIRMAN. Fine.

Senator HEINZ. Has Senator Shelby had a turn?

The CHAIRMAN. He has had a turn.

Senator SHELBY. Go ahead. I have had one round.

The CHAIRMAN. You have not had a turn. We will go to Senator Shelby after you have had your turn.

Senator HEINZ. All right, thank you, Mr. Chairman.

Gentlemen, I had a chance to read your testimony, and I must say after both reading and seeing the reports of the ABA's testimony, where you have, I gather, successfully accused the thrift industry of having eaten their cake and wanting to eat the bank industry's cake, too, I would simply want to remind all those groups that it is the taxpayers' lunch that is being eaten and at a cost that is pretty hard to swallow.

Let me ask you a couple of questions.

Last week when Bill Seidman was before the committee, I asked him about the difference in the Bush plan's regulatory powers granted to the FDIC for banks as opposed to those for thrifts. As you know, the FDIC will have greater powers to protect the insurance fund from the thrift industry than from your industry, the bank industry.

Bill Seidman responded when I asked him this question, that his stand on the issue was dictated by where he sat and that he sat on the deal he struck with the bank regulators.

Using the same principle, I can guess from where you sit, where you may stand on this issue, but I would like to know from a policy standpoint why the person charged with protecting the deposit insurance system should be in a weaker position to defend the funds from the bank industry than from the thrift industry.

Mr. Rideout.

Mr. RIDEOUT. Well, I think it is a matter of how you look at it, Senator Heinz.

We think with respect to the banking industry that the FDIC is in very strong position today and has been and has carried out its regulatory authority and charge very effectively over the years.

With respect to the thrift industry, one could argue that the reason it ought to be a little bit more far-reaching at this point or more stringent is just because of the difficult situation that we are coming through with the thrift industry and we need to, in effect, put in place and be sure that there is in place a very strong regulatory regime going forward.

Once that has been accomplished, I don't see why there isn't any reason at some point down the road that the Congress couldn't in effect back off the FDIC's authorities to make them equivalent to what they are with the banking system at this point in time, and that would be something certainly that the Congress could look at as we go forward.

But we think this regulatory item with respect to the S&L's is just extremely important, that there needs to be good, strong supervision, banklike supervision, and capital standards and accounting and the rest of that in order to bring that industry up to a sufficient standard where it can in fact be properly insured and adequately insured.

Senator HEINZ. Under the Bush administration's proposal, though, the healthy S&L's are going to be supervised by virtually the same people that supervise you. These are experienced regulators and examiners, and the troubled S&L's will be put in a trust. There are a number of insolvent thrifts that are currently being resolved. They are not involved here. They are being sold, merged, disbanded, liquidated.

It seems to me that what you will have are two sets of institutions, both with the same capital requirements, 6 percent by 1991. I am not clear on why sauce that is good for the goose isn't good for the gander.

Mr. RIDEOUT. Well, I can't tell you what was on the Treasury's mind or the White House's mind or the administration's mind, even the FDIC's mind with respect to that.

Senator HEINZ. No, I am not asking what was on their mind. I am asking you why is a revitalized, reorganized, resupervised thrift industry any different in terms of its regulatory needs vis-a-vis the insurance system than the banks?

Mr. RIDEOUT. I would presume in the long run, as I tried to say earlier, I don't think there really is any need for any differential, but I think perhaps it is just the suspicion that the Federal Home Loan Bank Board has been relatively weak—not in most recent months, but in most recent years—with respect to regulation and until there is, I guess, a return of confidence, a better comfort level with respect to the fact that the newly formed Federal Home Loan Bank System is getting the job done that there needs to be what one could call super oversight or extended oversight of their activities.

But again I would agree with you that once we have achieved that; in other words, once everyone has achieved, some sense of comfort that the regulatory system is working properly, then we can reduce that back.

Senator HEINZ. Let me go on to another question. All three of you, Mr. Haraf, Mr. Rideout, Mr. Tomson, in your testimony brought up some new items for consideration: the way the credit unions are regulated and insured; that money center banks should pay insurance premiums on foreign deposits; Money Market funds should be required to maintain reserves; and that the Cranston-D'Amato bill should be moved ahead. All these are certainly pertinent issues.

But do you want us to add those to this bill? Do you want us to get bogged down in debating and studying those issues and delay the enactment of this legislation, or are you saying please take these things up some other time?

Mr. Haraf.

Mr. HARAF. Senator, the Council believes that the problems of the S&L industry are urgent. They should be dealt with as promptly as possible without consideration of issues that are peripheral to the central issue of FSLIC insolvency. We would support expeditious movement.

Senator HEINZ. Mr. Rideout.

Mr. RIDEOUT. We certainly wouldn't want to have the progress of the bill hindered by discussing anything outside of what is in the bill as it relates to credit unions, and we think certainly what is in the bill with respect to putting their fund on a comparable kind of accounting basis with the FDIC fund and with the SAIF fund is an important thing.

What you have in effect there is doubling counting of assets in the way they account for their particular——

Senator HEINZ. Would you put Money Market funds having required reserves in the same category?

Mr. RIDEOUT. I would say that putting reserve requirements on Money Market funds is something that we ought to consider.

Senator HEINZ. But not necessarily in this legislation?

Mr. RIDEOUT. Not necessarily in this bill if it would cause delay.

Senator HEINZ. OK. Mr. Tomson.

Mr. TOMSON. We are concerned that the level of insurance stay where it is certainly. That is really not at issue here today. We are concerned about the cost of the insurance, and I think the suggestion that we put in there is to look at the base to see if a greater base of coverage isn't worthwhile to be considered here by including the foreign deposits.

Certainly, we are interested in a return to safety and soundness and stability at the earliest opportunity and that this legislation is a fair shot at doing that, and I think the first question that Senator Riegle asked us was did we feel that it was generally fair, and I responded "yes."

Senator HEINZ. Thank you, gentlemen.

The CHAIRMAN. Thank you, Senator Heinz.

I am going to put the remainder of my questions in the record. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

The administration's proposal would permit banks to buy healthy thrifts 2 years after the proposal's enactment.

Should the 2-year trigger date be eliminated; that is, should banks be permitted to buy healthy thrifts immediately upon passage of the law?

Second, what can we expect in the marketplace? Will the healthy and marginally healthy thrifts be snapped up and the Government;

that is, us here, left to clean up what is left with inadequate capital?

Got any comments? First, the Independent Bankers.

Mr. TOMSON. Well, I think certainly one of the considerations—and Mr. Rideout pointed out—is the capital considerations, and as an insurer I know you are looking for healthy capital to be a part of this industry, whether it is banking or thrifts, and you can't dispute that.

You know, philosophically, as independent bankers, community bankers, we have been opposed to concentration, and what we hate to see is the outgrowth of this being displayed in terms of fewer and fewer financial institutions, larger and larger in size and the concentration of the wealth and the control of these institutions.

And I think if you look back to December and see what it is that happened, what some of the deals that were cut, these institutions were delivered into the hands of a few, with strong control, and that is probably not going to change for decades or maybe generations again, and along with this went some very complimentary tax benefits, and so forth, and our feeling is that that is wrong and if healthy thrifts are a part of this package I wonder why they have to be included in here.

They are really not at issue as a part of this, and why do we have to bring them in here? If they are operating and are safe and sound, and so forth, why is it we need to promote the sale of those institutions at this particular point in time with this legislation?

Senator SHELBY. Mr. Rideout.

Mr. RIDEOUT. We agree with the bill as it reads with respect to healthy thrifts, although we would argue that if you could move that date back toward the time the bill is enacted, the sooner the better.

We think, as I mentioned, I think, in response to the question from Senator Roth, that the most important thing is to get capital flowing into the market, not only into those that are insolvent—and in fact some of those probably don't deserve to continue on as institutions. They probably need to be liquidated, and presumably the RTC will——

Senator SHELBY. The sooner the better, huh?

Mr. RIDEOUT [continuing]. Will do just that, and that of course is why we need to get the bill passed as quickly as possible and the funding in place to begin that process. But we think it is important to allow bank holding companies to acquire healthy thrifts and to do it on the same terms that our competitors can do it.

Senator SHELBY. What we would like for you to do is to get all the other thrifts first.

Mr. RIDEOUT. I understand that and certainly understand the rationale in the Bush administration's proposal——

Senator SHELBY. In our interest, too.

Mr. RIDEOUT [continuing]. To do that in terms of the ultimate cost to the taxpayer, et cetera. We understand those issues and support them, and we think it is going to be important to get as much capital focused in on this industry as we can.

Senator SHELBY. Yes, sir.

Mr. HARAF. Senator, there are probably about 1,000 institutions that currently do not meet the capital standard, to be imposed under this bill by June, 1991. Of that 1,000, experts say that a majority will not be able to meet those standards without outside help. Certainly, a large group within that majority are candidates for failure over the next couple of years.

It is critically important at this stage that regulators allow bank holding companies to participate in the reorganization of currently solvent but weak institutions before they become insolvent.

Making bank holding companies wait until an institution becomes insolvent before they are allowed to bid, will simply cost the taxpayer more money.

CAPITAL REQUIREMENTS

Senator **SHELBY**. Let me ask you this. Do you have a judgment on the second—on the capital requirements? What kind of capital requirements are we talking about moving from 3 percent, a minimum of 3 percent, to 6 percent by 1991? Overall just a judgment, we are talking about how many billions of dollars are going to have to be earned or raised in that period of time, a short period of time?

Mr. **HARAF**. Senator, I do not now have an answer to that question, but I can provide you with one.

Senator **SHELBY**. Would you? If you would do that and provide that for the record.

[The following was subsequently submitted for the record:]

Senator Shelby, our estimates are that the S&L industry will have to raise between $32 billion and $50 billion of new equity capital by June 1991, in order to meet the capital standards established by S. 413.

Senator **SHELBY**. But it would be a tremendous amount of money to be raised in the capital markets, equity markets, would it not?

Mr. **HARAF**. There is no question.

Senator **SHELBY**. Would it be unprecedented, that much money, in a short period of time for one industry?

Mr. **HARAF**. No, absolutely not, Senator.

Senator **SHELBY**. Not?

Mr. **HARAF**. Looking at some of the deals we have seen on Wall Street in recent years, I think the amount of funds over a 2-year span would certainly be feasible——

Senator **SHELBY**. But if market forces work, though, a lot of people wouldn't look at these deals like they would some of the other deals on Wall Street, would they?

You know, money follows what people think are good investments, doesn't it?

Mr. **HARAF**. Well, that is absolutely right. As I mentioned in my testimony, Senator, there are constraints today on the acquisition and operation of savings and loans that make it less profitable for the private sector to consider participating in the reorganization of this industry. The Council believes that every effort should be made to seek out, in a responsible way, private sector contributions of capital insofar as possible to help minimize the taxpayers' exposure in dealing with this problem.

Senator **SHELBY**. Yes. And if we are talking, as the Chairman says, at least $100 billion, some people say $200 billion and we really don't know what it is going to cost, do we?

Mr. **Haraf**. We don't know how much it is going to cost, that is right.

Senator **Shelby**. Yes.

Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Shelby.

Senator Garn.

Senator **Garn**. Thank you, Mr. Chairman.

I will have additional questions for submission in writing. In fact, I haven't asked any of the questions I intended to because my colleagues prompted follow-ons. That is true in this case, and don't misunderstand what I say.

As I have listened to the last 12 hearings here and those over 15 years, I've expected people to come in and testify in their own self-interest. If they didn't, I don't know who would protect them. So I am not being particularly critical.

Mr. Tomson, you said you are a banker and you came with that bias, and obviously that is understandable and you should. I wouldn't expect any of you to come in and testify on behalf of the S&L's. So that is the way it works around here.

But we have a broader obligation. The chairman has pointed it out over and over again in these hearings, and others of us have, too. We have gone beyond the arguments we have had over the years, the intramural battle between various parts of the financial services industry, and what we are dealing with is one hell of a loss to the taxpayers of this country who had nothing whatsoever to do with the problem.

You bankers can say that it wasn't your fault, and you are right, and 80 percent of the savings and loan industry can say it wasn't their fault, it was the 20 percent bad guys, and they are right.

But the bottom line is that the American taxpayer didn't have anything to do with it. We do, because we made a guarantee of the full faith and credit of this Government and the Treasury behind those insured deposits, and that is what we are attempting to bail out.

Not bad management. Not fraud, waste, and abuse. Not anything. Not the savings and loan industry. We are talking about bailing out the people who put deposits in thrifts that were guaranteed by their Government. That is our broader obligation.

And so it is fine to say that the IBAA is totally opposed, strongly opposed, to acquisition of healthy savings and loans by commercial firms. I don't understand that. At least from my perspective, I don't understand that.

I mean, Sears has had one for years. Commercial businesses have owned them.

I really don't care where the capital comes from. Any capital we can get into that industry is better than taking it from the taxpayer.

And so what you are saying, Mr. Haraf, really ought to be emphasized, that what we are talking about is maybe some prevention.

I look back to Garn-St Germain—what we tried to do in the emergency provisions there and the fight we got from everybody over interstate banking. My god, interstate banking.

And so what did we have to do? We had to simply sit back and say, OK, the only interstate acquisitions will be troubled institutions, whatever a troubled institution is. So we had to wait until they were half dead and then we could find a merger partner.

I have been around here a long time, and I have sat and listened to a lot of people testify. They change. The president of the ABA changes. The president of the IBAA changes. The testimony doesn't change very much over the years. [Laughter.]

The people change.

But trying to look at a broader taxpayer perspective, which is our responsibility to do, I can look back and see where these intramural fights over the years have been part of the problem, and everybody can share in that blame.

I would like to go back and say, "OK, we could have acquired some of these institutions that were marginal but could be called healthy." But I think a lot of these institutions could have been eliminated.

We wouldn't have faced December 1988 if $15 billion of FSLIC recap had been passed unrestricted and some of those institutions been put out of their misery 2 or 3 years ago rather than waiting until the last minute before the tax deadline.

We don't get much talk, certainly not in the press, about the things that were done and the background of it all. So I think you ought to know that if I can find a healthy institution out there and Ford Motor wants to buy it, that they have my blessing. If the Basses want to put $500 million of their money in it, it may not be enough in relationship to the whole thing. Maybe the M Bank and MCNB aren't enough. But with $250 million out of $4.2 billion that the FDIC is on the hook for, it is still $500 million and $250 million less than the taxpayers are going to have to pay.

And so I can't take any of your self-interest. Again, I am not being critical. I have got to sit back and try to judge. I am for finding capital from the private sector, that isn't taxpayers' money, every place I can. So if there is a healthy institution that has only 3 percent capital and we can get them up to 6 percent that way, I am for it.

I just wanted to let you know at least how this Senator feels about it and where I am coming from on this particular problem.

One other question, Mr. Rideout—I am going to give you an opportunity to answer a question that nobody has yet answered satisfactorily—because you have joined the herd marching down the line that says it is good to put the Federal Home Loan Bank System under Treasury.

Let me say before I get into the exact question, that I absolutely agree that the insurance fund should be separated from the regulator. I have no problem with this in the administration bill. I have no problem with the concept of independence. The regulator ought to be independent.

I fail to see where putting it in Treasury solves that problem. What we are talking about, at least in my opinion we ought to be talking about, is how to create a new independent Federal Home Loan Bank System, not political accountability.

Now, the Treasury and the administration have a very good answer for that. They go through all that I have just gone through:

The taxpayers are at stake. There are 100 billion reasons why we ought to change the regulatory structure. And so on. I can agree with all the rhetoric leading up to needing a change, but the issue in my opinion is not political accountability. It is independence, independence from the savings and loan industry. The FDIC ought to be independent from you guys. It is independent from Congress.

And I guess the point I would make is the same one that I made last night in a meeting about the effects on the taxpayer and the economy of putting the Federal Home Loan Bank Board under the gnomes of Treasury. It is a great idea to put the Fed under Treasury because every time Alan Greenspan plays with the money supply and every time he changes that discount rate, he has one heck of a lot more impact on this economy than anything that the President is doing or anything we are doing right now. We are all familiar with how much impact the so-called second most powerful man in the country, the Chairman of the Fed, has.

Then I suppose that it makes sense that we ought to just run the Chairman of the Fed right over to Treasury, so that the President of the United States, who is elected, has accountability and he can tell them what to do.

I don't want that kind of political accountability in the Fed, and I don't want that kind of political accountability in the bank and savings and loan regulatory agency. So to me putting it under Treasury is political accountability, and that is a different issue than independence.

WHY SHOULD THE FHLBB BE PUT UNDER TREASURY?

So I would like you to tell me why the ABA thinks it is a good idea, with specific reasons, not this "It is nice and comfortable and warm to put it over there and have some accountability." Why? Give me a good reason why that makes the Federal Home Loan Bank Board more independent.

Mr. RIDEOUT. Well, first of all, Senator, I am not sure—obviously taking off on your very last comment—that putting the Federal Home Loan Bank Board under the Treasury doesn't in fact make it more dependent. It puts more oversight in place, and I would certainly——

Senator GARN. Political oversight?

Mr. RIDEOUT. Well, certainly—yes, political oversight in the sense that the Treasury is political—if one can argue that the Treasury is writing the checks to pay for the case resolution under this plan, the taxpayer ultimately is writing the checks. If one defines that as political accountability, then I think that is very much the case.

I would go at it this way and give you the example of the Comptroller of the Currency. In other words, there are three major Federal banking regulators—the FDIC, to the extent that they are involved with State chartered banks; the Federal Reserve, to the extent that they are involved in the regulation and supervision of State chartered member banks, and then the Comptroller of the Currency.

Two of those regulators today, the FDIC and the Federal Reserve, are in fact independent. The Comptroller of the Currency, however, is not independent and has not been independent since it was founded back in the 1860's, whenever that Banking Act was passed back in the 1860's, and it certainly seems to me that the Comptroller of the Currency as a Federal banking regulator is functioning very effectively.

Senator GARN. Why then did the Fein study and the Hunt Commission recommend that the Comptroller be removed from Treasury and made independent?

Mr. RIDEOUT. Well, I guess I don't know what—I didn't read the Fein study or the Hunt Commission study. So I am not sure what all of those arguments are.

I can argue your side, that we ought to have an independent Federal Home Loan Bank System as a regulator. I accept——

Senator GARN. Why not put the FDIC under Treasury?

The arguments that the administration makes would just as well apply to the FDIC.

Mr. RIDEOUT. Well, I would just say this.

Taking your initial bias, as you stated, which is that the goal ought to be to have everyone independent, I think that certainly for purposes of a transition, in effect going from a system right now with respect to the Federal Home Loan Bank System and the fact that there seemed to have been some regulatory failures with respect to their duties over the last 5 to 10 years or perhaps even further back—we have a paper attached to our testimony which speaks to the history of regulation as far as the S&L——

Senator GARN. It should indicate that it changed rather dramatically in 1985.

Mr. RIDEOUT [continuing]. Industry is concerned.

There is no question that the efforts on the part of the Federal Home Loan Bank System in the last couple of years have been much improved. They have been dealing with a very difficult set of circumstances without the money, in effect, to do their duty as far as the insurance fund is concerned, and there is no question that the efforts have been there.

But perhaps, the best answer I can give you is that for an interim period at least it would make sense to——

Senator GARN. Why? What does Treasury add to what we want to accomplish?

That is the point that you are not answering either, and no one else does.

Mr. RIDEOUT. I guess I would just say it is an additional level of oversight.

Senator GARN. From whom?

Mr. RIDEOUT. From the administration.

Senator GARN. In Treasury?

Mr. RIDEOUT. Well, from the administration.

Senator GARN. Well, then why doesn't the FDIC need an additional level of oversight? They lost 25 percent of their capital last year, $4.2 billion, the first loss in their history.

I mean, $4.2 billion is still a lot of money in Utah.

Mr. RIDEOUT. Senator, I would just simply say that the FDIC seems to have over the years earned—they have had independence and they seem to have earned their independence, and I would simply say that certainly since the beginning of the late 1970's and early 1980's and perhaps going back further than that—and not including here the last couple of years where certainly some very honest, hard efforts have been made to move forward with stronger regulation on the part of the system, the Federal Home Loan Bank System—it has——

Senator GARN. What has stronger regulation got to do with putting it under Treasury?

We are agreed on the goal. There is no disagreement on the past problems of the Federal Home Loan Bank System, but the only answer we get from anybody, which does not satisfy this Senator, is that the Comptroller is over there.

So what? What difference does that make?

The Comptroller doesn't have a housing component. It doesn't have anything to do with housing in this country. That is important to this committee as well.

The Comptroller does not have 12 independent Federal Home Loan Banks out in the system. It is a different animal, and I see no reason for the Comptroller to be there.

You are talking about a political agency, an additional level of oversight, but I want to know what putting it under Treasury adds, because if it adds to the Federal Home Loan Bank Board we want to change the system.

We are taking the insurance function out of the regulator. Treasury pays the bills or authorizes payment for the taxpayer, but the FDIC is going to write the checks. You are going to find that most of the expertise in handling the S&L's comes from people who have worked for the Federal Home Loan Bank System but are now doing it for Treasury. You will also find that a lot of those people worked for the Comptroller, and they left the Comptroller when we took the pay caps off so that the Federal Home Loan Bank System could hire a couple of thousand more examiners—more qualified examiners—and keep them.

I am absolutely puzzled when all the sheep fall in line and come up with the same generalized answer—"the Comptroller does it that way." Boy, there are a lot of examples in this Government that somebody does it some way, but that doesn't make it right. And the only answers I get from everybody are that "the Comptroller does it that way," and "it is another level of oversight," when the issue is independence. Do we have a new Federal Home Loan Bank System that requires capital improvement, that has better examination, that doesn't have excesses, that deals with what the chairman and I are concerned about, the abuses of State legislatures with Federal insurance?

Those are the issues, and if somebody can give me a specific answer as to why it helps solve those problems, we can all agree on changing the structure to put it under the gnomes of Treasury. They are the same people that produced the tax bill of 1986, which we also love so much.

I would give you an opportunity in writing if you can come up with one. I don't think anybody can.

Mr. RIDEOUT. I apparently have failed, Senator.

We will be happy to file something for the record. Thank you.

Senator GARN. Mr. Tomson, I know you would like an opportunity to try.

Mr. TOMSON. Well, I personally happen to agree with you. Our association certainly signed off on the proposed legislation by the President. We see it as an expedient. At least it is something out there to start the ball rolling and get something done that has been long needed.

Obviously, the intent here is to improve on accountability, and you can call it political accountability, certainly at the expense of autonomy. I think all along we have always stood for a nonpolitical or depoliticizing the regulatory function to the greatest possible degree.

I don't understand why the OCC has to be under the hand of the Treasury Department. I think it could function better if it was a separate agency.

And Senator Heinz has left. He asked about the additional oversight that was needed possibly for banks as well as S&L's. I don't see that regulatory writing authority, for example, of the FDIC should be an aspect of oversight for the OCC necessarily.

The five-man board that will be placed over the top of the proposed insurance board, perhaps it should be separate and autonomous and have as much prominence as it can be given so it will function as an autonomous function.

The Federal Home Loan Bank Board hasn't worked. There is something wrong. It hasn't worked. It hasn't enjoyed the prominence. It hasn't enjoyed the leadership. It has failed miserably, and maybe we should go back and examine why.

I look back at the Federal Reserve System when it first came into being in 1913, and at that time, and I think up until 1935, the Secretary of the Treasury sat on the Federal Reserve Board, and that was changed with the Banking Act in 1935 so they could enjoy more autonomy.

The Federal Home Loan Bank Board is not involved in monetary policy and fiscal policy. It doesn't have the prominence of the Federal Reserve Board certainly, but maybe there is a compromise there. If it was perhaps left to enjoy its autonomy, at least semiautonomy, and put the Secretary of the Treasury over on that Board such as the manner in which we handled the Federal Reserve System for a period of—what was that—20 some years. I haven't had time to go back and see just why that was changed. I know we got into a debacle in 1935 and there was a quarrel over the manner in which the Board would be constituted. I think Governor Echols was certainly important at that time in getting that changed.

But it is a thought, anyhow, of how we might compromise this situation.

Senator GARN. Well, you haven't helped by generally agreeing with me. You still didn't answer my question, and I would challenge somebody to come up with some specific justifiable reasons for putting it under Treasury because again we are not arguing the point of whether the Federal Home Loan Bank Board has done a good job or all of that. We are all agreed that changes seem to be necessary and that we should separate the insurance function.

But this handing it over to Treasury just doesn't make any sense to me at all. It doesn't add to the solution to the problem. It may not hurt it, but on the other hand, it seems to be an unnecessary measure that could harm it if you have political accountability in there. I would hate to have had certain Presidents' policies played out if they had had direct authority to tell some of the independent agencies of this country how to operate and what to do, and certainly that has been true of the Fed.

Whether we like the Fed's decision or not, I don't think any of you would like us, as was tried once in this very room, to decide what the monetary growth target should be for the year by legislation. You would not want a President to be able to call up a Chairman of the Federal Home Loan Bank Board and say don't you dare raise that discount rate because it might hurt me politically.

I see Treasury as a political accountability step, not real oversight. Where is the expertise in Treasury to oversee this kind of an operation? It is going to work if you make the new Federal Home Loan Bank System independent and have the capable examiners and people who are paid enough to stay there and be smarter than the cheaters out in the system, to catch them; and that is what is going to solve this problem, not political accountability through Treasury to a President.

The Chairman has been very kind and let me go on at least three times since my last questioning period. I promised him I had two brief questions. So I will stop.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, those are very interesting and important comments and a very important part of the record.

Gentlemen, thank you for your testimony today, and we look forward to further conversations with you.

The committee stands in recess until 10 o'clock tomorrow morning.

[Whereupon, at 12:29 p.m., the committee was recessed, to reconvene at 10 a.m., Thursday, March 9, 1989.]

PROBLEMS OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION [FSLIC]

PART III OF IV

THURSDAY, MARCH 9, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m. in room SD-538, Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Cranston, Dixon, Sanford, Graham, Bryan, Garn, D'Amato, Bond, Mack, and Pressler.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. Let me invite those in the room to find seats, and we will begin our hearing this morning. We have the Tower matter on the Senate floor and other committees meeting at this very hour on a variety of subjects. Many of the members of this committee are required to be elsewhere at this particular time. The chairman of the Senate Budget Committee, Senator Sasser, who's an important member of this committee, is conducting a hearing upstairs in the Budget Committee. I'm also a member of that committee and would like to be up there myself, but that's not possible. We're also in session in the Senate Finance Committee this morning on the President's budget. I happen to be a member of that committee, and I'd like to be there too, but that's the nature of our situation: that members will be coming and going in the course of the morning.

We have with us today three important witnesses that I will introduce just a little bit later. Let me make a brief set of opening comments.

Today's hearing will mark the 13th day of hearings on the FSLIC savings and loan problem. We have with us a panel of three financial industry representatives, and I am particularly pleased that we have them here with us today. We are making, I think, good progress on this legislation. I think the witnesses we have had previously and the active work of all the members of the committee and the staff put us in the position to stay on track toward meeting the timetable that we have set out before.

I anticipate that we will complete our committee schedule of hearings on time next week, and when we have completed those hearings, we will accelerate the effort to begin putting together whatever adjustments and modifications to the administration's plan the committee judges to be necessary. I hope that we would develop the committee proposal over the Easter recess and have it ready for committee markup very early in the week following that recess. Assuming we can act as a full committee in a prompt fashion, we can then move it to the floor at the first available opportunity and move it through the Senate as a whole.

So, I feel good about that. I feel we are on track and making good progress.

The administration's bill has a host of important provisions that affect banks as well as healthy thrifts. We have received conflicting opinions about whether the Home Loan Bank System should be under the Treasury Department, how quickly bank capital requirements should be phased into the thrift industry, and under what conditions banks should be able to buy thrifts.

We've also had differing views about the appropriateness of thrifts with State charters using additional powers that have a higher risk profile and at the same time doing that with a direct connection to Federal deposit insurance. That's a major part of the reason that $100 billion is missing. We want to have your arguments on these matters expressed here today. Of course, there are many issues concerning the insurance funds themselves, whether the additional premiums are fair, workable, what the logos will be that will be used, and what circumstances will permit rebates of premiums as we go forward into the future.

With that, I want to introduce our witnesses this morning. We have Charles Zwick, who is the chairman of the Subcommittee on Legislative and Regulatory Issues of the Association of Reserve City Bankers. He is also the chairman of the Southeast Bank in Miami, FL.

We have Mr. Frank McKinney, of the Association of Bank Holding Companies, who is also the president of BancOne Corp., headquartered in Indianapolis, IN, and his holding company includes banks that are in various cities in the State of Michigan, so we are interested in his perspective from the point of view of the upper Midwest.

Also testifying today is Mr. H. M. Osteen, of the Association of Thrift Holding Companies, who is as well the chairman of Bankers First based in Augusta, GA.

We welcome you here this morning and my colleagues will be coming and going in the course of our discussion today. I'd like to ask you, Mr. McKinney, if you would want to begin.

Let me just say also that we will make your full statements and any associated documents a part of the committee record. I would ask you as you go through to try to summarize and go to those points where you think we ought to consider adjustments or changes in the administration's package.

STATEMENT OF FRANK E. McKINNEY, JR., CHAIRMAN, ASSOCIATION OF BANK HOLDING COMPANIES

Mr. McKINNEY. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I am Frank McKinney, president of the BancOne Corp. and also chairman of

BancOne Indiana Corp. and BancOne Indianapolis, and I'm a resident of Indianapolis, IN.

I am grateful for the opportunity to appear before you this morning in my capacity as chairman of the Association of Bank Holding Companies to give you the views of our members concerning S. 413.

This is a summary of a written statement that was submitted to your committee and I will be brief.

We support President Bush's reform proposal. The administration's plan would improve the safety and soundness of the thrift system. I would like to present a summary of our position. Basically we would put our proposals into four categories, those being: prompt action; separation; supervision; and funding.

PROMPT ACTION

In the category of prompt action, prompt action is needed to close insolvent thrifts. Every week of delay adds hundreds of millions of dollars to the total cost of solving the S&L crisis. The Bush plan provides a solid basis for helpful legislation. It is now the job of Congress to make sure that funds are available as soon as possible to close insolvent thrifts and bring down the spiraling FSLIC deficit.

The key first step to containing costs is rapid closure of insolvent thrifts. Allowing these thrifts to stay open is causing a hemorrhaging of Federal funds. The Government lacks the cash currently to close these thrifts until Congress passes legislation.

SEPARATION

In the category of separation, the maintenance of separate insurance funds for the historically separate banking and thrift industries is absolutely essential. Banks and thrifts have been regulated and supervised differently, by different agencies, and have exposed the taxpayers to wholly different risks. The FDIC, funded by banks, remains in substantial surplus; FSLIC, by contrast, has run up a deficit that has exposed taxpayers to tens of billions of dollars. Operating separate funds for banks and thrifts is essential to assigning responsibility for the bailout, and maintaining accountability for its resolution. The Association of Bank Holding Companies agrees with FDIC Chairman Seidman that the proposal by the administration to increase the level of the FDIC's bank fund and to increase assessments on banks is "reasonable and prudent" so long as limits are placed on the increases.

SUPERVISION

Concerning category number three, which was supervision, tough, substantive reforms are needed to prevent a recurrence. The public must be assured that this disaster will not recur. Admirable elements of the Bush plan include: Imposing on thrifts the strict regulation and supervision applied to banks; bringing the Federal Home Loan Bank System under the Secretary of the Treasury; and providing a central role in thrift oversight for the newly constituted FDIC.

The failures of the current thrift regulatory system call for major change. To eliminate the current disparity between bank and thrift regulation, the Association of Bank Holding Companies strongly supports having both the Chairman of the Federal Home Loan Bank System and the Comptroller of the Currency report to the Secretary of the Treasury, on grounds of equity, uniformity, safety and soundness, and accountability.

Banks today are held to much stricter standards in areas including accounting, examination, capital standards, and supervision. To restore the integrity of S&L supervision and regulation, a firm deadline must be fixed in the law for thrifts to comply with bank regulatory standards.

FUNDING

The final category is funding. In our written statement we proposed three ways—those being increasing FSLIC premiums, the reserve revenue plan, and the creation of a new full faith and credit borrowing entity.

The administration's plan earns high marks for its handling of safety and soundness issues. But, improvements in the administration plan are called for on issues separate from the safety and soundness issues. We propose, that at least four specific areas of the plan can be improved.

BANK HOLDING COMPANY ACQUISITION OF THRIFTS

Area one involves bank holding company acquisition of thrifts. The administration deserves support for its proposal to allow bank holding companies, beginning two years after enactment, to acquire healthy thrifts without the burdensome "in tandem" restrictions that now prevent efficient operation of acquired thrifts. Bank holding company acquisitions of thrifts should be strongly encouraged in order to supply capital and disciplined management to thrifts, and reduce cost to the taxpayers.

The proposal, however, should be improved in four ways. First, acquisition of healthy thrifts should be permitted now, to allow bank holding companies to purchase both insolvent and healthy thrifts in the same transaction, thereby reducing the cost to the insurance fund and hence the taxpayers. Second, the branching authority of a thrift acquired by a bank holding company should be explicitly retained, as advocated by FDIC Chairman Seidman, who will have coresponsibility for deciding on the safety and soundness of thrift activities. Third, acquired Federal S&L's should be permitted to continue the activities they were conducting in their service corporations prior to the acquisition, such as insurance and real estate brokerage, et cetera. The current proposal limits post-acquisition activities to those permitted under section 4(c)(8) of the Bank Holding Company Act—an unnecessary restriction not related to the safety and soundness issues. Fourth, the current regulatory treatment of good will mandated by the Federal Reserve Board for bank holding companies must be modified.

CROSS GUARANTEES

The second area involves cross-guarantees. An unnecessary part of the administration's plan is to provide authority to the FDIC to obtain reimbursement from "commonly controlled" institutions for up to 2 years after sustaining a loss in one or more of the institutions. This "cross-guarantee" proposal is a substitute for the FDIC's controversial recommendation last year to enforce, at the agency's discretion, a merger of all banks within a multi-bank holding company in the event of an insolvency in one of them. In contrast to the urgency of closing insolvent thrifts, there is no emergency requiring the inclusion of "cross-guarantee" authority in S. 413. Like its predecessor, the new proposal is controversial. It should be the subject of separate hearings and later consideration by the committee. Moreover, it is the kind of idea that should be incorporated in the study proposed in title X of S. 413.

DEPOSIT INSURANCE ASSESSMENTS

The third area involves deposit insurance assessments. The administration's plan establishes a new concept that the FDIC's fund should achieve and maintain a ratio of 1.25 percent of insured deposits. Assessments charged banks would be increased to accelerate achievement of the new target. The Association of Bank Holding Companies believes both steps are reasonable and prudent. In addition, however, we believe the bill should include revisions to the present assessment/rebate arrangements so that deposit insurance premiums are properly adjusted once the target of 1.25 percent is achieved.

CRIMINAL SANCTIONS

The fourth area concerns criminal sanctions. The members of the Association of Bank Holding Companies are keenly interested in eliminating criminal behavior in depository institutions, and have supported the regulators' joint proposal to increase penalties that was included last year in S. 1886, and H.R. 5094, as modified by the House Judiciary Committee. Now the administration proposes certain increases in penalties which are, in our view, excessive. We question the wisdom, for example, of penalties for a crime against a depository institution being made double that mandated for assault with a deadly weapon. Also, we question the imposition of a 5-year jail term for violation of regulations under the Bank Holding Company Act, many of which are complex and susceptible to varying interpretations. Using the findings of the House Judiciary Committee as a guide, the penalties should be proportionate to similar crimes under other administrative regimes.

Mr. Chairman, that would conclude my summary and I thank you.

[The complete prepared statement of Frank E. McKinney follows:]

ASSOCIATION of BANK HOLDING COMPANIES

Statement of

Frank E. McKinney, Jr.

Chairman

Association of Bank Holding Companies

before

Committee on Banking, Housing & Urban Affairs

United States Senate

Washington, D C.

March 9, 1989

Mr. Chairman and members of the Committee, I am Frank E. McKinney, Jr., President of Banc One Corporation, Columbus, Ohio, and Chairman and Chief Executive Officer of Banc One Indiana Corporation and Bank One, Indianapolis, Indiana. I am grateful for the opportunity to appear before you this morning, in my capacity as Chairman of the Association of Bank Holding Companies, to give you the views of our member companies on S. 413, the Administration's bill to revamp FSLIC, the Federal Home Loan Bank Board, the regulation and supervision of savings and loan associations, and to increase deposit insurance premiums for FDIC-insured institutions. We are an Association of 105 bank holding companies accounting for approximately 65% of U.S. commercial banking assets.

Banc One Corporation is a multi-bank holding company with 56 bank subsidiaries located in five states--Ohio, Indiana, Michigan, Wisconsin and Kentucky. Of the 56 banks, 18 are state chartered and 38 are national banks. In addition to the banking subsidiaries, Banc One has non-bank subsidiaries engaged in mortgage banking, leasing, consumer lending, discount brokerage, and investment management services.

Overview

From the standpoint of the public, there are several essential components of any FSLIC rescue plan. The first must be to stop the hemorrhaging of government funds by taking firm, prompt action to close the insolvent institutions. Every week of delay adds millions of dollars to the cost of this undertaking. President Bush deserves great credit for developing a comprehensive plan in a timely manner and then authorizing work to begin on handling the insolvencies even before Congress acts. Also, Mr. Chairman, you deserve great credit for your prompt and thorough consideration of the plan.

Second, substantive reform proposals, with teeth in them, are needed so the public can be assured that this disaster will not recur. In this area, key elements include bringing the Chairman of the Federal Home Loan Bank System under the general oversight of the Secretary of the Treasury; providing a central role for the FDIC; and imposing bank-type regulation and supervision on S&L's.

Finally, a sound plan will isolate the virus by providing that the FDIC's fund and its income be kept entirely separate from the funding mechanisms authorized for the Federal Home Loan Bank System.

All of these elements are present in the Administration's proposal. The members of this Association believe, consequently, that the President's plan is fundamentally sound, and we support it.

Banking's Environment

Before moving into a discussion of the Administration's specific proposals, I should like to briefly sketch in the current environment in which banking operates today. Our industry faces an uncertain future due to the combination of increased competition, higher costs of regulation, and outdated banking laws. As this Committee well knows from its pioneering work on Glass-Steagall reform last year, competitors of bank holding companies enjoy real advantages. Because they are not subject to bank regulation, the array of financial products and services that can be offered by [illegible]rd, General Electric, Sears, American Express, etc., are far superior to those that can be offered by the members of this Association

Competition, of course, is not limited to domestic financial services firms. Foreign banks now have a 28% share of commercial loans to U.S. firms, and are competing with our members on smaller and smaller credits and very thin spreads. One result of these competitive pressures is that today no U.S. bank ranks among the top 25 in the world.

In order to stop the erosion of banking's competitive position, we need changes in the laws, and this Association is dedicated to working with Congress to achieve these improvements. As President Bush said on February 6, public policy should aim at achieving a safe, sound, and profitable (emphasis added) banking system. The legislation before you appropriately addresses the first two of these goals; the achievement of all three should be a high congressional priority.

To assist the Committee in moving ahead with modernizing banking laws, we will soon be providing Committee members with a draft bill being proposed jointly by our Association and the American Bankers Association. The bill authorizes formation of financial services holding companies and provides a framework for orderly expansion of products and services by banks and affiliated financial entities such as insurance companies and securities firms. We believe it will, along with other such proposals, provide an excellent basis for discussion of the future of financial institutions.

Housing Finance

I should like to comment also on a question the Chairman raised in his letter of invitation as to "the need for, and viability of, a separately regulated thrift industry devoted primarily to housing finance?" I would like to point out that the Federal Reserve Board, in the monetary policy report that supplemented Chairman Greenspan's February 21 testimony before this Committee, addressed this question as follows:

> Despite the turmoil in the thrift industry, there has been no noticeable disruption of mortgage activity. In part, the development of a deep secondary mortgage market has separated the origination of loans from the need to fund them. For this reason, the base of mortgage credit has been broadened in recent years, making the provision of mortgages far less dependent on the condition of any one type of financial institution or on the regional supply of loanable funds. During the 1980's, the share of home mortgage credit held in securitized form has increased from about ten percent to more than one-third. The spread between interest rates on fixed-rate mortgages, which have an average life of roughly ten years, and yields on ten-year Treasury notes did not change appreciably over 1988, which also implies that the mortgage markets continued functioning well despite the problems of many savings and loan associations.

This comment, and others like it, suggest that the answer to the Chairman's question is not so much an economic one as it is political. Whether a separate thrift industry dedicated to housing continues into the 21st century will depend on the degree of commitment Congress has to a set of specialized institutions dedicated by law predominantly to originating residential mortgages and, in many cases, to holding them in their portfolios. Without a specific congressional mandate to remain so highly specialized, it is quite likely that thrift institutions will become more diversified in their activities, an outcome that, as the Fed has suggested, may not have a noticeable effect on the supply of home mortgage credit.

The Administration's Plan

I shall now turn to a discussion of the various elements of the Administration's plan. In so doing, I shall attempt to distinguish between what we perceive to be the fundamental aspects of the plan--having to do with safety and soundness--and other aspects that are subsidiary to the necessities of safety and soundness and are susceptible to modification.

In this regard, there is an obvious caveat. The major focus of the plan, as the draft bill's statement of purpose makes clear, is to restore public confidence that has been weakened by the S&L crisis. Included in the plan as well are substantial increases in the insurance premiums assessed on FDIC-insured institutions. The S&L portion of the bill clearly is emergency legislation; the portion dealing with FDIC matters, however, is not. As Congress considers this legislation, it would do well to keep in mind that the banking industry is sound; there is no crisis confronting FDIC.

- **Separation of FDIC's Finances from FSLIC.** In the words of Secretary Brady:

> . . . The separate insurance funds will not be commingled, and premiums from each industry will be used only for its own insurance fund. . . . (N)ot one penny from commercial banks will go to any S&L resolution or to the new savings association insurance fund. . . . .

Implementation of this policy is crucial to the banking industry's support of the Administration's plan. In addition to our concerns as managers of institutions that have contributed over the years to a soundly-financed and administered fund, we also strongly believe that the American public deserves to know there is a safe and sound insurance fund backing up commercial bank deposits. To make that assurance credible, Congress much make clear in the law that FDIC's money cannot be sequestered for purposes of shoring up FSLIC or its successor--or for any other governmental purpose, for that matter. Maintaining the integrity of the FDIC fund as a discrete entity in the face of the calamity within the S&L industry assumes, therefore, the highest priority for the banking industry.

- **Subjecting FHLBS Chairman to Direction by the Secretary of the Treasury.** Bankers have lived with the present arrangement that places the Comptroller of the Currency within the Treasury Department, and we see no reason, on grounds of equity and uniformity, not to place the chief federal regulator and supervisor of our competitors on the same basis. Over the years, a tremendous disparity has developed in the regulation and supervision of national banks and federal savings and loans. One way that this disparity can be effectively eliminated is to provide that both the Comptroller and the Chairman of the new FHLBS report to the same person. This Association consequently strongly favors this proposal.

- **Imposition of Bank-Type Supervisory Requirements.** Again, the members of the Association strongly support this proposal. The sympathetic regulatory and supervisory accommodations granted S&L's over the years in many cases breached the standards of safety and soundness. To restore the integrity of S&L regulation and supervision, individual institutions must be required to meet the same standards banks are required to meet--across the board. This includes accounting and capital requirements and examination standards. In order to make certain this transition takes place, a firm date must be fixed in the law. Buying time has proven to be a disastrous course for public policy; to follow the same course in the future will likely produce the same calamitous results. The date selected by the Administration--June 1, 1991--is reasonable and we support it. Exceptions beyond that date should not be allowed.

- **Increased FDIC Fund and Premiums.** As discussed earlier, the banking industry is in a tight cost bind that is growing tighter. There are many in the banking industry who are convinced that the FDIC's fund can be restored to an appropriate level with no change in the FDIC's premium structure. Nevertheless, the members of the ABHC are more inclined to agree with FDIC Chairman Seidman, who told this Committee on February 28 that the Administration's proposal raising FDIC premiums "seems reasonable and prudent." Our members are prepared to accept the increases in the level of the fund and in premiums in order to eliminate any question about the ability of FDIC to meet calls on the fund. We do this, of course, on the condition mentioned earlier that the premiums and the fund are dedicated, by law, for this purpose only.

As you know, the Administration is recommending that the FDIC's assessment rate be changed as follows. Presently, the FDIC assesses a premium at the rate of 1/12 of one percent per year on each insured bank's average deposit liability plus other items. Under the recommendation of the Administration, the assessment rate in calendar 1990 would be fixed at 12/100 of 1% and in calendar 1991 and thereafter would be fixed at 15/100 of 1%. This will mean that banks will soon be paying over $3 billion a year in FDIC assessments into the newly-named "Bank Insurance Fund" (BIF).

At the same time, the Administration proposes to increase the size of BIF until it equals 1.25% of insured deposits. This means an increase to about $22 billion, or roughly 50% greater than the fund's current level. This substantial reserve should prove to be entirely sufficient to meet any foreseeable need (the ratio of 1.25% is close to the historical average level of the fund over the last 25 years), and suggests to us, as Chairman Seidman indicated in his testimony, that a return to lower premiums should be possible after about 1995.

Therefore, when the 1.25% ratio is achieved, we would favor a mandated reduction in the FDIC's assessment from the 15/100 of 1% that will be in effect at that time. If the fund's ratio were to fall below a certain level, say 1.1% of insured deposits, then the higher premium could be restored until the target of 1.25% is again reached. Such an arrangement will assure a fund sufficient to meet all foreseeable needs.

In this connection, we question whether FDIC should be given discretionary authority to increase either the target ratio or assessments up to a maximum of 35/100 of 1% with a cap of a 50% increase in any one year. The Administration's target of 1.25%, as I indicated, is likely to prove entirely sufficient to meet FDIC's needs. Consequently, there is no demonstrated need for this significant enhancement of FDIC's authority. Should FDIC's board at some point determine that increases in the fund's ratio or assessments are needed--beyond the substantial numbers proposed in the bill--they could request Congress at that time to make the change. In sum, even with the attendant safeguards prescribed in the bill, we believe the additional grant of authority is excessive, and the case for its enactment has not been made.

Finally, the present assessment/rebate arrangements, which have been in place for many years, should be addressed by this Committee. The Administration's proposal to fix the BIF at 1.25% creates the opportunity to examine the assessment/rebate system with a view toward improving it. We believe this can be done in a way that ultimately will allow for reduced assessments on banks while still maintaining the fund at a safe and sound level. I am attaching as Appendix A a longer discussion on this issue that is vital to banking's future prosperity.

- **Bank Holding Company Acquisition of S&L's.** The Association strongly supports the Administration's proposal allowing bank holding companies, after two years, to acquire healthy S&L's without the requirement, imposed by the Federal Reserve Board, that an S&L must be operated as a completely independent entity not "in tandem with any other subsidiary" of the acquiring bank holding company.[1] As this Committee knows, bank holding company acquisitions of failed S&L's are now permitted, but the tandem restrictions still apply. It has been our contention since 1971 that legislation is unnecessary to accomplish what the Administration proposes. Nevertheless, we welcome this initiative.

At the same time, however, significant impediments remain. If Congress wishes to reduce costs to taxpayers, it must find ways of attracting buyers willing to pay a premium to take over the franchises of insolvent S&L's. From our point of view, every reasonable incentive should be made available to buyers in order to facilitate as many transactions as possible. The opportunity for the banking industry to provide both disciplined management and additional capital for the S&L industry should not be missed by retention of unnecessary restrictions. Several additional steps need to be taken to eliminate impediments for bank holding companies to acquire these institutions.

First, the two-year delay for acquisition of healthy thrifts should be eliminated. Doing so would have several beneficial effects: (1) it would help ease the shortage of capital and disciplined management that exists in the S&L industry; (2) it would eliminate the tandem restrictions immediately; and (3) it would enable the liquidators of insolvent S&L's to offer bank holding companies the opportunity to purchase, in one deal, both an insolvent and a healthy thrift, or some combination thereof. The prompt authorization of the purchase of healthy S&L's therefore can be expected to serve as a helpful complement to the present authority for bank holding companies to acquire failing S&L's.

Second, Congress should allow federal S&L's acquired by bank holding companies to continue, through their service corporations, all of the activities they may now conduct. Currently, federal S&L's can engage, pursuant to federal regulation, in certain activities not permitted bank holding companies.[2] The Administration's proposal would require that any activities beyond those permitted under sec. 4(c)(8) of the Bank Holding Company Act be terminated immediately. This serves as a disincentive for bank holding companies to acquire thrifts. Moreover, there can be no question as to the safety and soundness of these activities for S&L's, because they go back many years and have not proven to be excessively risky.

Third, Congress should make sure that the branching authority of an S&L acquired by a bank holding company be retained. In support of our position recommending this, and the other changes I have cited above, I commend to you Chairman Seidman's testimony before your Committee in which he made essentially the same recommendations. Since the FDIC will have the ultimate responsibility for deciding on the safety and soundness of S&L activities, it seems appropriate to give Mr. Seidman's views on this subject great weight.

A fourth significant disincentive is the treatment of good will that affects bank holding companies as a result of the recently-adopted capital guidelines of the Federal Reserve Board. The treatment of good will is especially relevant in S&L acquisitions since many S&L's have large amounts of good will on their balance sheets. As of September 30, 1988, for example, over 100 S&L's had good will totaling more than 6% of their total assets. Nearly all of the 100 S&L's were insolvent, and thus are among those the government will be most eager to have taken over. Any non-bank firm seeking to acquire such S&L's will be free to use normal accounting procedures in structuring the acquisition, and therefore amortize the good will arising out of the transaction, spreading the cost over a number of years. Commercial banks and their parent holding companies, however, do not have this advantage. They will be required to deduct any good will from their basic capital. This will serve as a major disincentive for bank holding companies to bid on S&L's that are carrying substantial amounts of net worth on their balance sheets. Some modification of this rule therefore is called for in order to make such acquisitions practicable.

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[1] Footnotes at end of statement.
[2]

- **Funding.** The Association's members want the funds available to deal with the S&L problem to be adequate. We also believe that it is imperative to get on with the business of closing or merging the insolvent institutions. Therefore, we agree with Chairman Greenspan that it is not necessary to iron out every detail, or answer every question, at this stage. Clearly the funds involved are huge, and the process of dealing with the problem S&L's will be a lengthy one. Any fine tuning that turns out to be necessary can be done later on. The important priority now should be to give FDIC and the other agencies the requisite authority and funds to get started.

I should like to mention that banks now hold about $37 billion in required reserves at Federal Reserve banks. Assuming a normal rate of return, this means the Federal Reserve System in 1988 earned about $3 billion on these reserves, and these earnings, after deduction of expenses, were then turned over to the Treasury. I would propose that these earnings might be earmarked for FDIC's use, rather than being returned to the Treasury's general fund. FDIC's board then could decide how best to allocate the revenues between the old FSLIC, and the two new funds under its jurisdiction. This "reserves revenue plan," as I call it, does not generate new revenue for the government as a whole, but would underscore the major contribution that commercial banking makes to the operation of the federal government through the earnings the government receives on required reserves. And the "reserves revenue plan" would in fact provide additional income for FDIC over and above its current sources. I commend it to you for your consideration.

- **Cross Guarantees.** A highly unusual provision in the Administration's bill would authorize the FDIC to obtain reimbursement from "commonly controlled" institutions at any time within two years of sustaining a loss in one or more of the institutions. (No liability arises from losses at a commonly-controlled S&L for five years after the event.) This proposal first appeared in the January 4 study of the FDIC entitled, "Deposit Insurance for the Nineties." It substitutes for an earlier proposal advanced in 1988 by the FDIC that generally was not well received. The earlier proposal would have given the agency power to enforce a merger of all banks within a multi-bank holding company in the event of the insolvency of one of them. In a letter to then-Chairman Proxmire dated June 29, 1988, Chairman Greenspan raised questions about the enforced merger idea and suggested that a hearing be held on it before the Committee acted. The earlier proposal was not acted upon by the last Congress and has now, as I indicated, been superseded.

From our perspective, the new proposal merits similar careful study before it is acted upon. Very little time has elapsed since it first appeared, and more time is needed to consider it. Moreover, as I suggested earlier, there is no emergency existing that would require this Committee to include cross guarantees in the FSLIC rescue legislation. In fact, it is just the kind of proposal that should be included in the study called for in the bill by the Secretary of the Treasury in conjunction with the other regulatory agencies. For example, one important issue not addressed by the FDIC proposal is whether it is correct to limit the effect of the bill to corporately-controlled institutions. By doing so, the proposal exempts systems of "chain banks" from such cross guarantee requirements, and thus enhances the privileged status of such banks. In this era of tightened regulation, it is not clear that such an exemption is appropriate.

In short, we are concerned that legislation to authorize cross guarantees may be neither fair nor, in the long run, as effective as FDIC expects it to be. We believe that other alternatives deserve to be explored as well. Consequently, the Association urges the Committee *not* to include this controversial and non-critical proposal in the current legislation.

- **Criminal Sanctions.** The members of the Association are keenly interested in eliminating criminal behavior in depository institutions, and have traditionally supported requests by bank regulators for enhanced enforcement authority. Last year, we supported the proposal embodied in S. 1886 authorizing increased enforcement authority that had been submitted jointly by the bank regulators. Now the Administration has resubmitted the proposal, but in so doing has greatly increased the recommended penalties for violations. We believe the end result is to go well beyond what may be appropriate in an understandable desire to rid the S&L industry of bad actors. Under the bill, as an example, offenses against financial institutions would carry a maximum term of 20 years, which is double that applicable to felons convicted of assault with a deadly weapon. Moreover, penalties are increased for violations, even technical violations, of the Bank Holding Company Act and its implementing regulations and orders, even though we are unaware of the need for increasing such penalties. Attention must be given by the Committee to clarifying the types of violations to which the sanctions apply and to making the sanctions proportionate to the violation. The House Judiciary Committee's findings of last year relating to H.R. 5094 provide excellent guidance. Attached to my statement as Appendix B is a detailed discussion of these provisions together with recommendations for improvements.

* * *

Mr. Chairman, this concludes my statement. I will be happy to respond to any questions you or other members of the Committee may wish to address to me.

FOOTNOTES

1/

The conditions, including tandem restrictions, that the Federal Reserve Board has imposed upon bank holding company operation of acquired thrifts are as follows:

1. A bank holding company will operate an acquired thrift as a savings and loan association having as its primary purpose the provision of residential housing credit. The acquired thrift will limit its activities to those currently permitted to thrift institutions, but shall not engage in any activity prohibited to bank holding companies and their subsidiaries under section 4(c)(8) of the BHC Act.

2. The acquired thrift will not establish or operate a remote service unit at any location outside of its home state.

3. The acquired thrift will not establish or operate branches at locations not permissible for national banks located in its home state.

4. The acquired thrift will be operated as a separate, independent, profit-oriented corporate entity and shall not be operated in tandem with any other subsidiary of the bank holding company. The bank holding company and the acquired thrift will limit their operations to effect this condition and will observe the following conditions:

a) No banking or other subsidiary of the bank holding company will link its deposit-taking activities to accounts at the acquired thrift in a sweeping arrangement or similar arrangement.

b) Neither the bank holding company nor any of its subsidiaries will solicit deposits or loans for the acquired thrift, nor shall the thrift solicit deposits or loans for any other subsidiary of the bank holding company.

5. The bank holding company shall not change the thrift's name to any title that might confuse the public regarding its status as a nonbank thrift institution.

6. The acquired thrift will not convert its charter to that of a national or state commercial bank without the Board's prior approval.

7. To the extend necessary to insure independent operation of the acquired thrift and prevent the improper diversion of funds, there shall not be transactions between the acquired thrift and the bank holding company or any of its subsidiaries without prior Fed approval. This limitation encompasses the transfer, purchase, sale or loan of any assets or liabilities, but does not include infusions of capital from the bank holding company, the payment of dividends by the thrift, or the sale of residential real estate loans from the acquired thrift to any subsidiary of the bank holding company.

FOOTNOTES (Continued)

2/

Currently, federal thrifts can invest up to 3 percent of their assets in service corporations. Such service corporations can engage in two classes of activities: (1) those "reasonably related" to the activities of a federal thrift, and; (2) those of a pre-approved nature are found at 12 CFR § 545.74(c), including:

-- originating, selling, purchasing (including participations in), servicing, or otherwise dealing in certain loans, including real estate, home improvement, education, consumer (including inventory and floor planning loans), and commercial loans.
-- performing certain operations, management consulting, and advisory services primarily for the internal operations of financial institutions, including credit analysis, construction loan inspection, developing and administering personnel benefit programs.
-- real estate management (including agricultural real estate);
-- real estate development.
-- acquiring improved real estate or manufactured homes to be held for rental or resale or for remodeling, renovation or demolishing and reguilding for sale or rental;
-- acquiring improved real estate or manufactured homes to be held for rental or resale or for remodeling, rennovating or demolishing and rebuilding for sale or rental;
-- making investments in community development projects or small business investment companies;
-- engaging in interest rate futures transactions;
-- engaging in financial options trading;
-- investments in U.S. government obligations and certain other federal and state agency obligations;
-- other investments that are permissible for a federal S&L;
-- preparing state and federal tax returns for individuals or nonprofit organizations;
-- insurance brokerage or agency for liability, casualty, automobile, life, health, accident, or title insurance, but not private mortgage insurance;
-- providing fiduciary services upon application to the FHLBB;
-- issuing notes, bonds, debitures, and their obligations or securities;
-- issuing credit cards;
-- leasing personal property, including office equipment;
-- providing data processing tax services to the extend permitted for federal S&Ls; and
— issuing letters of credit.

Appendix A

Deposit Insurance Assessments

The Association of Bank Holding Companies offers for consideration a series of recommendations for changes in the law governing deposit insurance assessments of commercial and mutual savings banks insured by FDIC.* The recommendations take as a point of departure the underlying premise of the plan advanced by Treasury Secretary Brady: namely, that the new Bank Insurance Fund must be strong enough to eliminate any question about the ability of FDIC to meet its costs through calls on the fund, rather than on the taxpayer.

To implement the plan, Secretary Brady has recommended that Congress authorize an increase in the BIF to 1.25% of insured deposits, and to quickly reach that goal by a substantial increase in deposit insurance assessments on commercial banks. The ratio of 1.25% is in accord with the average ratio maintained by FDIC over the last 25 years, and should be entirely sufficient to meet any foreseeable need. When the target level is achieved, about 1995, the fund will be over 50% larger than it is today--approximately $22 billion.

By 1995, BIF will have a cash flow well in excess of $4 billion, including income from assessments on banks and from interest on its portfolio of U.S. Treasury securities. This large cash flow will cause the trust fund to grow well above the target ratio, assuming that FDIC's expenses return to historical norms. Thus, as Chairman Seidman has indicated, lower assessment rates should be possible.

The key element of the Treasury's plan, which ABHC endorses, is maintenance of the deposit insurance fund at 1.25%. This establishes a fund that promises to be entirely sufficient. Should the figure prove to be low, then Congress can raise it. However, there are no indications that it will be inadequate. If the BIF's ratio falls below 1.25%, it can be rebuilt to the mandated level by an increase in premiums. And, if the ratio climbs above 1.25%, premium reductions should be introduced.

ABHC believes that both the current FDIC system of rebates, and the rebate system included in the Treasury plan can be improved. Unless the rebate system is revised, commercial banks will be forced to pump additional millions of dollars into the BIF after the 1.25% ratio is reached, because in effect *there is no way to turn off the money spigot under current law. Without the* changes ABHC proposes, the BIF will continue to grow well above the 1.25% target ratio, and well beyond what historically is justified.

We therefore propose:

First, when the 1.25% target is reached, assessments should drop from 15 basis points to a level determined by FDIC to be needed to maintain the BIF at this target level.

Second, both assessment income and investment income should be used to meet FDIC's expenses. The present law mandating that all expenses be paid out of assessment income only should be changed. Other federal insurance funds, notably the Securities Investor Protection Corporation (SIPC) and the National Credit Union Share Insurance Fund (NCUSIF), make use of investment income to pay the bulk of their expenses, thereby assuring a low assessment on insured institutions once the funds reach a predetermined level.

Third, Current law requires the FDIC in any given year to carry forward expenses that exceed assessment income. If FDIC's expenses exceed assessment income in any year, the "deficit" is carried forward and, along with the new expenses, deducted from assessment income in succeeding years. Assuming adoption of the Administration's target ratio, the need for carry-forward accounting is eliminated. The law should be changed to recognize this.

Fourth, if BIF's ratio of reserves to insured deposits falls below 1.1%, then FDIC should be authorized to increase automatically the assessment rate to the maximum allowed by law--15/100 of 1%. This will assure that if the fund drops precipitously, as it did in 1988, the corporation will be able to rebuild BIF to its target level with reasonable speed.

It is possible that a combination of assessment reductions and rebates could substitute for a system of straight premium reductions. The important point is that FDIC (or BIF) should not just be permitted, but mandated, to rebate unneeded premium income when the fund is being maintained at its target ratio. Assessments paid in by banks should be used only to maintain the fund at that prescribed level. Any excess should be returned, in the form of lower premiums, rebates, or a combination of the two.

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* A chart summarizing the status of current law affecting key elements of the deposit insurance assessment process, corresponding provisions of S. 413, and revisions recommended by ABHC is attached.

Present Law	Treasury Proposal	ABHC Recommendation
Assessment rate:	Assessment rate:	Assessment rate:
1/12 of 1% of deposits, equal to 8.3 basis points.	1/12 of 1% in 1989 12 basis points in 1990 15 basis points in 1991.	Same as Treasury proposal until the target 1.25% ratio in BIF is achieved. Mandatory reduction at that time to a lower assessment rate. Restoration of the 15 basis point assessment if the fund falls below 1.1%.
Fund size:	Fund size:	Fund size:
Deposit fund to be kept in a range between 1.25 and 1.40 percent of insured deposits.	Target of 1.25% of insured deposits. May be higher at FDIC discretion.	Maintain fund at 1.25% of insured deposits.
Rebates:	Rebates:	Rebates:
Up to 60% of net assessment income may be rebated to banks. If the ratio of the fund falls below 1.10 percent, the maximum rebate is cut to 50%; if the ratio exceeds 1.40%, FDIC must increase the rebate to maintain the fund at a 1.40% ratio.	No rebates until the fund attains the target ratio of 1.25% of insured deposits. Rebates then resume at the lesser of the amount necessary to reduce the ratio to 1.25% or 60% of net assessment income.	Rebates replaced preferably by reductions in assessments based on FDIC's estimate of income needed to maintain BIF at 1.25% ratio. Reductions in assessments (or rebates) would be mandatory, unless FDIC determines that its costs in the forthcoming year will reduce BIF below 1.25% ratio. If BIF falls below 1.1% ratio, FDIC could reimpose 15/100 of 1% assessment rate until 1.25% ratio is achieved.
Definition:	Definition:	Definition:
Net assessment income is defined as annual gross assessment income minus FDIC expenses and insurance expenses and losses.	Present definition retained.	The term "net assessment income" means the total assessments which become due during the calendar year less the amount by which FDIC costs exceed the Corporation's investment income for the calendar year.

Present law:	Treasury proposal:	ABHC recommendation:
Investment income: The deposit insurance fund is invested in U.S. Treasury obligations, and interest earned is added to the fund.	Investment income: Same as present law.	Investment income: Interest earned is used to meet FDIC costs, along with assessments on banks.
Carry-over:	Carry over:	Carry over:
When FDIC expenses exceed assessments in any year, the excess costs are carried forward and paid from future assessment income.	Same as present law.	Carry over is made unnecessary, replaced by the target 1.25% ratio.
Special assessment:	Special assessment:	Special assessment:
No authority except to eliminate rebates.	FDIC may impose, under certain conditions, an assessment rate higher than 15/100 of 1% up to a maximum of 35/100 of 1%. Assessment increase would be limited to 50% in any one year.	No new authority.

Appendix B

CRIMINAL PENALTIES PROPOSED IN S. 413 SHOULD BE REDUCED

Although the Association of Bank Holding Companies (ABHC) supports enhanced enforcement of the criminal laws relating to financial institutions, ABHC submits that the increased criminal penalties proposed in S. 413, the Administration's proposal for reform of the laws governing financial institutions, are flawed in two important respects. First, existing misdemeanor penalties, rather than the proposed felony sanctions, are most appropriate for violation of the complex and ambiguous regulatory scheme created under the Bank Holding Company Act (BHCA) because criminal penalties apply even in the absence of evil intent or purposeful disregard of the law. Last year, the House Judiciary Committee rejected as "unnecessarily harsh" a similar proposal to impose felony sanctions for violation of BHCA regulations or orders.[1] Second, the proposed penalties for fraud, bribery, theft and embezzlement in financial institutions are disproportionately severe.

The ABHC supports the House Judiciary Committee's carefully considered conclusion that felony sanctions for violation of BHCA regulations or orders are unduly severe. S. 413 would punish violations of the BHCA _or_ the regulations and orders issued thereunder with sentences of up to five years imprisonment plus fines of up to $1,000,000 per day of violation. The current maximum penalties are one year imprisonment plus a $10,000 fine for individuals, and $1000 per day for institutions. Although the ABHC believes that the existing misdemeanor penalties are sufficient to deter violations of the BHCA as well as its implementing regulations and orders, any enactment of more severe penalties should be consistent with the House Judiciary Committee's conclusion that "a violation of a regulation is more appropriately treated as a misdemeanor."[2]

The Administration bill also would amend the "financial institution offenses" -- crimes of fraud, embezzlement, theft, and bribery relating to financial institutions, 18 U.S.C. 215, 656, 657, 1005, 1006, 1007, 1014, and 1344 -- to provide for maximum criminal penalties of 20 years imprisonment plus fines of $1,000,000 or more. These penalties are disproportionate with penalties for other serious fraud crimes. ABHC submits that maximum penalties of 10 years, coupled with the very substantial criminal fines and civil penalties provided in the bill, will effectively and proportionately deter these serious frauds.

As Congress focuses on amendments to criminal penalties in response to the crisis in the savings and loan industry, it should address itself primarily to the laws applicable to the fraud that is in part responsible for the current thrift industry crisis. Reform of the penalties provided in the BHCA, in contrast, is neither needed to deter violations nor central to the Congressional purpose of putting America's financial institutions back on solid ground. ABHC is not aware of any evidence of substantial infractions of the BHCA under the existing law. Moreover, unlike the fraud which has drained critical financial resources from the thrift industry, any occasional infractions of the BHCA's regulatory requirements which may have occurred have not substantially affected the safety or soundness of our financial system.

1. _Violation of Bank Holding Company Act Regulations or Orders Should Not Be a Felony._

As the House Judiciary Committee concluded in considering H.R. 5094 -- the banking reform bill -- last year, the imposition of felony penalties for regulatory violations is inappropriate. Under current law, "willful" violation of any provision of the BHCA, _or_ "any regulation prescribed by or order issued by the appropriate Federal depository institutions regulatory agency" pursuant to the BHCA, is a misdemeanor. 12 U.S.C. 1847(a). Institutional violations carry criminal fines of up to $1000 per day, and individual violators are subject to up to one year imprisonment and a $10,000 fine.[3] _Id._ S. 413 would make willful violation of the Act, the regulations, or administrative orders a felony carrying maximum criminal sanctions to $1,000,000 per day and 5 years imprisonment for individuals, and $1,000,000 per day for an institution.[4] S. 413, sect. 903(b)(1).

After hearings and committee debate on proposals to amend the criminal provisions in H.R. 5094, the House Judiciary Committee, with jurisdiction and expertise covering Federal criminal sanctions, struck proposed felony penalties for violation of agency regulations and orders because it found that existing misdemeanor penalties were more appropriate. The Committee considered the proposed felony penalties for violation of the regulatory scheme "to be unnecessarily harsh and incommensurate with the treatment accorded other crimes," and concluded that "a violation of a regulation is more appropriately treated as a misdemeanor."[5] According to the Judiciary Committee, its formulation -- providing one year terms for violations of regulations or orders and five year terms for violations of the Act -- "keeps the 'teeth' in the criminal penalties of the legislation while removing those penalty provisions that are ill advised."[6]

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[1] H.R. Rep. No. 822, Pt. 3, 100th Cong., 2d Sess. 3.

[2] _Id._ at 12.

[3] Any company or individual violating the Act or regulations or orders is also subject to civil penalties of up to $1000 per day. 12 U.S.C. 1847(b)(1).

[4] It also would increase the maximum civil penalties to $1,000,000 per day for willful violations and $25,000 for other violations, and would provide that criminal and civil penalties are cumulative. S. 413, sect. 903(b)(2).

Under S. 413, a bank holding company employee faces the risk of committing a felony without even knowing that he or she is acting illegally. Unlike the malum in se crimes of fraud or embezzlement which involve deceitful takings, the acts forbidden by the BHCA are "malum prohibitum" -- i.e., they are not inherently immoral or evil but rather are illegal only because the Act prohibits them. Moreover, the "willful" intent requirement in the BHCA does not require the prosecution to prove that the defendant knew of the statutory or regulatory rule and breached it nonetheless; it only requires the prosecution to show that the defendant undertook an action which constitutes a violation willfully. Given that the BHCA and its implementing regulations and orders contain many pages of complex and ambiguous rules, knowledge of all of the governing rules cannot be assumed. In these circumstances, where there may not be clear notice of what constitutes a felonious act and evil intent cannot be presumed, felony sanctions are inappropriate. Therefore, ABHC embraces the House Judiciary Committee's conclusion that the existing misdemeanor penalties for violations of regulations and administrative orders should be left undisturbed.

2. Penalties for Financial Institution Offenses are Disproportionate.

In the interest of equity, sentences for criminal violations are established according to the principal of proportionality -- comparable crimes should carry comparable sentences. The proposed penalties for financial institution offenses contained in S. 413 are disproportionate.

The maximum prison terms for individuals convicted of financial institution offenses under existing law are from two to five years. 18 U.S.C. 215, 656, 657, 1005, 1006, 1007, 1014, and 1344. S. 413 would increase the maximum penalties to 20 years

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[5] H.R. Rep. No. 822, Pt. 3, 100th Cong., 2d Sess. 3, 12.

[6] Id. at 12.

imprisonment plus fines of $1,000,000 or more. S. 413, sect. 915.

ABHC supports increased prosecution of those institution-related parties who engage in fraud, criminal deceit, embezzlement, theft or bribery. ABHC also recognizes that increased maximum penalties may serve as an added deterrent to these crimes. However, the proposed 20 year sentences are disproportionate with the penalties for other serious frauds. For example, the maximum prison term for securities fraud under the new insider trading law is 10 years. Pub. L. No. 100-704, sect. 4, 102 Stat. 4677, 4680 (1988). The maximum penalty for mail fraud is 5 years and $1000. 18 U.S.C. 1341. Moreover, the proposed penalties exceed those applicable to serious violent crimes. For instance, assault with a deadly weapon carries a maximum penalty of only 10 years and $10,000. 18 U.S.C. 111. The maximum sentence for bank robbery is $5000 and 20 years imprisonment. 18 U.S.C. 2113. ABHC submits that 10 year prison terms, in addition to the bill's very substantial new criminal fines and civil penalties, would provide an ample and proportionate deterrent.

The **Chairman**. Thank you, Mr. McKinney.

Let me now indicate other members have arrived and I'd like to see if others have opening comments they want to make. Senator Garn.

Senator **Garn**. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR GARN

Senator **Garn**. Today we begin the final phase of our FSLIC hearings, which is to hear the comments of industry representatives. The witnesses today represent the thrift industry, which will obviously feel the most direct effects of the administration's plan.

Not surprisingly, your testimony—particularly the U.S. League's—can be summed up this way: Make the taxpayer pick up more of the burden; give us forbearance to meet new capital standards; don't touch our Government-sponsored Federal Home Loan Banks; and leave our regulator alone.

I disagree on all four counts. The taxpayers should not pick up more of the burden because they are the least responsible for the mess we're in. The thrift premium increases called for by the administration plan seem reasonable to me. Until someone proves to me that they will do more harm than good, I will support them, although I can understand the argument that at some point the premiums should be equalized with banks.

I also believe that it is more than reasonable to require that the Government-sponsored Federal Home Loan Banks share in the ongoing burden of this problem. They may be "owned" by member thrift institutions, but they are profitable because they use Uncle's Sam's name. Using $300 million a year of these profits to help pay for the problem is totally fair. And it will not impair their ability to pay the same level of dividends that they always have to their member thrifts.

Second, I continue to believe that capital forbearance is a lousy idea. The only penalty for failing to meet the 1991 capital standard is a mandatory limit on growth: It is not forced liquidation or merger. That seems reasonable to me. We may have to tinker with some very-limited exceptions, but I cannot support another blanket forbearance provision.

Third, we can and should reorganize the structure of the Federal Home Loan Banks to minimize their influence of regulation and supervision. Again, the Government has an interest in these institutions and provides them with benefits, and we need to protect that interest.

Finally, you should not be able to keep your regulator as is. While I agree that the Bank Board should not be put under Treasury, make no mistake about where I am coming from: Whatever we decide to do, you can be sure that the new regulator of savings institutions will be much more independent from industry influence.

I am sick and tired of the media accusing Members of this body of shilling for the U.S. League because of opposition to moving the Bank Board under Treasury. Our challenge is to create an independent regulator; that does not mean we have to move it under Treasury.

The CHAIRMAN. Thank you, Senator Garn. Senator Mack.

Senator MACK. Mr. Chairman, I don't have any opening comment other than to welcome the panel and a special warm welcome to my friend, Charlie Zwick from Florida.

The CHAIRMAN. Very good. Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, I do have a short opening statement and I appreciate your giving me this opportunity to put it in.

Mr. Chairman, today's witnesses represent one of the principal sources of private capital that might be available to save the S&L farm. Private capital is the sweet steady rain that will best serve to end the drought that imperils the still healthy thrifts that remain in the field. I hope that the bill that this committee produces is a powerful rain maker.

On the subject of capital, I would like to echo the earthy wisdom of my colleague, Senator Garn, in his closing remarks at yesterday's hearing. He said that if the private capital rain does not arrive soon, there is no other choice but to irrigate with taxpayers' funds. And we all know how expensive Federal water projects can be.

Therefore, we should plow aside every barrier that might impede the flow of private capital to the roots of the thrift industry. If we succeed, we should continue to reap a harvest of strong mortgage lenders. Indeed, unless we do clear away for private capital, any talk of looking out for the taxpayers in this process is just so much fertilizer.

I want to thank you, Mr. Chairman and I'm delighted I could rely upon those earthy comments of our ranking member, Senator Garn.

The CHAIRMAN. Thank you, Senator D'Amato.

Senator Bryan.

Senator BRYAN. Mr. Chairman, I'm not going to try to improve upon that. I will yield to another metaphor.

The CHAIRMAN. Very good.

We will now hear from Mr. Osteen.

STATEMENT OF H. M. OSTEEN, JR., VICE PRESIDENT, ASSOCIATION OF THRIFT HOLDING COMPANIES

Mr. OSTEEN. Thank you.

Mr. Chairman and members of the committee, I am Monty Osteen, chairman of the board and chief executive officer of Bankers First Corp., a thrift holding company headquartered in Augusta, GA.

I am appearing before you today in my capacity as vice chairman of the Association of Thrift Holding Companies, and this association of thrift holding companies is the only organization having thrift holding companies as its members, with membership restricted to thrift holding companies and thrifts contemplating establishing a thrift holding company. We represent 40 companies with assets ranging from $25 million to over $200 billion to form the nucleus of the association.

Mr. Chairman, the bill that you have introduced at the request of the administration, Senate Bill 413, the Financial Institutions Reform, Recovery and Enforcement Act of 1989, not only represents a constructive solution to the problems of the thrift industry but also provides the opportunity for a fundamental review of the structure of the banking system in this country, a review that we believe is long overdue.

The primary objective of the bill, of course, must be to devise a solution to the current problems associated with insolvent and failing thrift institutions with as little drain on Treasury's funds as possible. The essential element in this solution is the attraction of capital to the thrift industry. This in turn could be done by removing the artificial constraints in current law that detract from the value of the thrift charter and by deleting or amending several provisions in the bill that would further lower this value by placing savings associations at a competitive disadvantage with commercial banks.

We believe that some of the funding and other provisions in the recovery program should be deleted or amended, but I would remind you that this association of thrift holding companies supported the administration's $15 billion FSLIC recapitalization program when many in the S&L industry opposed it, and we support the major elements of this proposed legislation.

We also believe that time is of the essence. It is urgent that this bill be enacted as soon as possible. FSLIC-insured institutions are presently experiencing deposit outflows of approximately $8 billion a month. This deposit outflow constitutes a direct reduction in the collective value of thrift charters of approximately $300 million per month, applying the generally accepted broad guideline that the market value of a charter ranges between 4 and 4.5 percent of an institution's total deposits. This serious outflow represents an increased cost to the American taxpayer because of losses in the FSLIC system and the industry's contribution to the proposed new insurance fund will be serviced from a deposit base of diminishing size. Every dollar the industry cannot provide will be provided by the taxpayers.

Another urgent reason to act now is that interest rates are rising and if rates exceed administration's estimates at the time the various agency obligations are issued, the entire program will cost more than the thrift industry's contribution will be diminished while taxpayers are required to pay more.

It has been over 55 years since the last fundamental restructuring of the banking and financial sector of our national economy. Since that time, the nature of the financial services marketplace and the institutions in it have changed radically. These changes have occurred within a patchwork regulatory structure that has not kept pace with these changes.

The communications and electronic revolution has resulted in global financial markets operating on a 24-hour basis, instantaneous transfer of funds, and financial instruments unheard of 15 years ago, securitization of virtually every type of receivable, eradication of geographic constraints to market expansion, and the proliferation of nondepositories that offer consumers the functional equivalent of traditional banking services. These revolutionary changes have occurred within a regulatory framework that entails different regulators for the same kind of institutions, multiple agency regulations of the same institutions, and sometimes the subjection of a single institution to conflicting policies by agencies with overlapping jurisdiction.

For example, the securities activities of individual S&L's are regulated by the Federal Home Loan Bank Board, while those of its holding company are regulated by the Securities and Exchange Commission. There are a total of five Federal agencies that deal with securities and antitrust matters for the entire banking system. The two deposit insurance funds have different sets of capital, accounting and regulatory policies. Duplicate regulation of the same entity results in increased costs, delay and uncertainty. The lack of functional regulation frequently creates artificial advantages for one set of institutions over another because of conflicting policies among these agencies. Contributing to this regulatory chaos has been the piecemeal but uneven erosion of the archaic barriers to geographic and product expansion enacted in the 1930's which themselves created artificial preferences for certain types of institutions.

These developments have resulted in the evolution of a financial system in this country that has hobbled not only in its ability to meet competition from domestic nondepository companies but also in its ability to compete in world markets.

The bill addresses several of these problems by restructuring the deposit insurance system, reorganizing the Bank Board within the Treasury Department, eliminating conflicting rules on transactions with affiliates of banks and savings associations, and by repealing several outmoded restrictions on the operation of thrift holding companies.

As promised by Treasury Secretary Brady here on February 22nd, the cause of functional regulation will be furthered immeasurably and overlap eliminated by separate legislation transferring administration of the disclosure and other requirements of the Securities and Exchange Act of 1934 for bank and savings associations from their regulators to the Securities and Exchange Commission. All publicly held companies, including thrift and bank holding companies, are now under the jurisdiction of the SEC.

We believe that the transfer of the deposit insurance function of the Federal Savings and Loan Insurance Corporation to the Federal Deposit Insurance Corporation and the chartering and other functions of the Bank Board to the Treasury Department will return stability to the thrift industry and restore public confidence in the thrift industry and the deposit insurance system. It would also place the regulation of deposit insurance on a functional basis for the first time.

The new regulatory structure is complicated, however, by vesting authority to set separate capital standards in the chairman of the new Federal Home Loan Bank System and the creation of three new insurance funds. It also proposes higher insurance assessments and separate logos for savings institutions. We believe that there should be parity between savings associations and banks on capital standards, premiums and logos. There is no reason to require the bank system chairman to develop a separate duplicate set of capital requirements and to worry about which standards are less stringent than those in national banks.

My association favors an amendment to the bill providing savings associations be subject to the uniform risk-based capital standards developed in accordance with the Basel Accord. Capital standards in accordance with this accord have been adopted by the Federal Reserve Board and are under consideration by other banking agencies. This standard should include the 10-year good will write-off in the bill for capital computation only and not for financial statement purposes. Such statement should be presented in accordance with generally accepted accounting principles. This ten-year period should be fixed by statute, rather than permitting the chairman of the bank system to set a shorter period as provided in the bill.

The imposition of uniform risk-based capital standards would avoid the necessity for discriminatory deposit insurance assessments and separate logos. Most importantly, it would restore public confidence in the thrift industry, improve earnings, and preserve the value of the thrift charter.

We believe also that the new system would be even more efficient if the two existing insurance funds were combined into a single fund with a uniform logo and a single insurance assessment schedule. The bill would actually create three funds—the bank insurance fund, the savings association insurance fund, and deposit insurance fund, which is a combination of the first two. A single fund would avoid the duplication of efforts and added costs of administering three separate funds.

The creation of the single fund would not—I repeat—would not require a commingling of bank and savings institution funds since separate accounting could be established and easily maintained on the books of a single entity. Let me emphasize that we do not endorse a commingling of the deposit insurance funds.

Irrespective of the structure of the new insurance system and the kind of capital standards adopted, we believe that there is no economic justification for the imposition of the higher insurance premium on financially sound savings institutions nor is there justification for separate logos.

We support the transfer of the functions of the Bank Board to the new bank system located in the Treasury Department under a single chairman. This arrangement will inspire public confidence in the thrift industry. It has worked well for the Office of the Comptroller of the Currency and there has been no history of undue interference by the Secretary of the Treasury in the affairs of national banks. This arrangement is consistent with the goal of functional regulation and has the added advantage of permitting the resolution of overriding banking policy issues within a single department in the executive branch.

Mr. Chairman, the administration's recovery program will be enacted in vain if the integrity and value of the thrift charters are diminished as a result of provisions which reduce thrift association powers to directly or indirectly or with lower earnings for the value of assets.

One proposal that would do this is in section 218 and 314 of the bill which would require that savings association deduct from their capital, loans and investments and financial accommodations to subsidiaries that are engaged in activities that are not permissible for national banks. This requirement would place healthy savings associations at a competitive disadvantage with commercial banks with regard to the attraction of capital. This provision also diminishes their investment powers indirectly by removing the economic incentive for associations to invest in subsidiaries engaged in activities inherent in the thrift charter.

The CHAIRMAN. Let me just stop you for a minute.

Mr. OSTEEN. I'm sorry. I didn't see that my light is red.

The CHAIRMAN. What I'd like to ask you to do if you can is to try to conclude any key points you want to emphasize, and then we'll reserve the rest of our time for questions.

Senator DIXON. Mr. Chairman, I wonder if I could have consent to put a statement in the record.

The CHAIRMAN. By all means. Without objection.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee continues its hearings on the problems of the thrift industry. I look forward to hearing the testimony of Frank McKinney of the Association of Bank Holding Companies, H.M. Osteen of the Association of Thrift Holding Companies, and Charles Zwick of the Association of Reserve City Bankers. As the committee reviews the administration's recapitalization and regulatory reform proposal, and as we craft the legislation which will best serve the public, it is useful to hear the perspectives of the various segments of the financial services industry affected by the legislation.

Essentially, this legislation has two parts: Improving our regulatory system and funding the Government's obligation to insure deposits in sick thrifts. In the end, however, these two parts are not separate; how carefully we answer the regulatory issues will determine how much money American taxpayers must pay.

We must improve our regulatory system—in many ways. We must insist that thrifts have real capital, not phony capital, on their balance sheets. We must demand a regulatory system that prevents institutions from "betting the bank". We must be certain that, when thrifts or banks do make loans, U.S. taxpayers do not again get stuck paying off the bad bets, that is, the bad debts.

The regulatory system that emerges from this legislation should leave thrifts with the opportunity to make a profit. If it does not, far more than 500 thrift insolvencies could result. That would jack up the bill to our taxpayers far beyond its current, painfully large size. Fixing our regulatory system is a most important task; it must be done courageously and carefully.

Thank you, Mr. Chairman.

Pardon me for interrupting you, Mr. Osteen.

Mr. OSTEEN. OK, Mr. Chairman. I would conclude with the comment that this portion of the bill should be amended and that the assets of all financial institutions be determined under generally accepted accounting principles and basically we support the contention that all accounts be dictated by generally accepted accounting principles and we fully support the amendments to the Thrift Holding Company Act that enhance and increase the value of the thrift charter.

Thank you very much.

[The complete prepared statement of H. M. Osteen Jr. follows:]

STATEMENT OF

H. M. OSTEEN, JR.
Vice Chairman
Association of Thrift Holding Companies

before

Committee on Banking, Housing, and Urban Affairs
United States Senate

March 9, 1989

Mr. Chairman and members of the Committee, I am H. M. Osteen, Jr., chairman of the board and chief executive officer of Bankers First Corporation, a thrift holding company with headquarters in Augusta, Georgia.

I am appearing before you today in my capacity as vice chairman of the Association of Thrift Holding Companies ("ATHC" or "Association"). The Association of Thrift Holding Companies is the only organization having thrift holding companies as its members. With membership restricted to thrift holding companies and thrifts contemplating establishing a thrift holding company, 40 companies with assets ranging from $25 million to over $200 billion form the nucleus of the Association.

At the time of the passage of the Savings and Loan Holding Company Act Amendments of 1967, there were 98 thrift holding companies holding 16 percent of all FSLIC-insured deposits. Today, 365 thrift holding companies hold over 43 percent of all FSLIC-insured deposits. The Association of Thrift Holding Companies was formed in November 1985 in response to the growth in thrift holding companies and the need to provide services and representation in Washington, D.C. to these types of companies.

I.
Introduction

Mr. Chairman, the bill you have introduced at the request of the Administration, S. 413, the "Financial Institutions Reform, Recovery and Enforcement Act of 1989" ("FIRREA" or "bill") not only represents a constructive solution to the problems of a segment of the thrift industry, but also provides the opportunity for a fundamental review of the structure of the banking system in this country, a review that we believe is long overdue.

The primary objective of the bill, of course, must be to devise a solution to the current problems associated with insolvent and failing thrift institutions with as little drain on Treasury funds as possible. The essential element in this solution is the attraction of capital to the thrift industry. This, in turn, can be done by removing the artificial constraints in current law that detract from the value of the thrift charter, and by deleting or amending several provisions in the bill that would further lower this value by placing savings associations at a competitive disadvantage with commercial banks.

We believe that some of the funding and other provisions in the recovery program should be deleted or amended, but I would remind you that the Association of Thrift Holding Companies supported the Administration's $15 billion FSLIC recapitalization program when many in the S&L industry opposed it.

We also believe that time is of the essence. It is urgent that this bill be enacted as soon as possible. FSLIC-insured institutions are presently experiencing deposit outflows of over $8 billion a month. This outflow constitutes a direct reduction in the collective value of thrift charters of approximately $300 million per month, applying the generally accepted broad guideline that the market value of a charter ranges between 4 to 4.5% of an institution's total deposits. This serious outflow represents an increased cost to the American taxpayer because the losses in the FSLIC system and the industry's contribution to the proposed new insurance fund will be serviced from a deposit base of diminishing size. Every dollar the industry cannot provide will cost the taxpayer a dollar.

Another urgent reason to act now is that interest rates are rising. If rates exceed Administration estimates at the time the various agency obligations are issued, the entire program will cost more and the thrift industry's contribution will be diminished while taxpayers will be required to pay more.

II.
Need for Structural Reform

It has been over 55 years since the last fundamental restructuring of the banking and financial sector of our national economy. Since that time, the nature of the financial services marketplace, and the institutions in it, have changed radically. These changes have occurred within a patchwork regulatory structure that has not kept pace with these changes.

The communications revolution has resulted in global financial markets operating on a twenty-four hour basis, instantaneous transfer of funds, novel financial instruments unheard of fifteen years ago, securitization of receivables, eradication of geographic constraints to market expansion and the proliferation of non-depositories that offer consumers the functional equivalent of traditional "banking" services. These revolutionary changes have occurred within a regulatory framework that entails different regulators for the same kind of institution, multiple-agency regulation of the same institution and sometimes the subjection of a single institution to conflicting policies by agencies with overlapping jurisdiction.

For example, the securities activities of individual S&Ls are regulated by the Federal Home Loan Bank Board ("Bank Board") while those of the holding company parent are regulated by the Securities and Exchange Commission. There are a total of five Federal agencies that deal with securities and anti-trust matters for the entire banking system. The two deposit insurance funds have different sets of capital, accounting and regulatory policies.

Duplicate regulation of the same entity results in increased costs, delay and uncertainty. The lack of functional regulation frequently creates artificial advantages for one set of institutions over another because of conflicting policies among these agencies. Contributing to this regulatory chaos has been the piecemeal, but uneven, erosion of the archaic barriers to geographic and product expansion enacted in the 1930's, which themselves created artificial preferences for certain types of institutions.

These developments have resulted in the evolution of a financial system in this country that is hobbled, not only in its ability to meet competition from domestic non-depository companies, but also in its ability to compete in world markets.

The bill addresses several of these problems by restructuring the deposit insurance system, reorganizing the Bank Board within the Treasury Department, eliminating conflicting rules on transactions with affiliates of banks and savings associations and by repealing several outmoded restrictions on the operation of thrift holding companies.

As promised by Treasury Secretary Brady here on February 22, 1989, the cause of functional regulation will be furthered immeasurably and overlap eliminated by separate legislation transferring the administration of the disclosure and other requirements of the Securities Exchange Act of 1934 for banks and savings associations from their regulators to the Securities and Exchange Commission. All publicly held companies including thrift and bank holding companies are now under the jurisdiction of the SEC.

III.
Restructuring of the Deposit Insurance and Thrift Regulatory Systems

We believe that the transfer of the deposit insurance functions of the Federal Savings and Loan Insurance Corporation to the Federal Deposit Insurance Corporation and the chartering and other functions of the Bank Board to the Treasury Department will return stability to the thrift industry and restore public confidence in the thrift industry and the deposit insurance system. It would also place the regulation of deposit insurance on a functional basis for the first time.

This new regulatory structure is complicated, however, by vesting authority to set separate capital standards in the Chairman of the new Federal Home Loan Bank System ("Bank System"), and the creation of three new insurance funds. It also proposes higher insurance assessments and separate logos for savings associations.

We believe that there should be parity between savings associations and banks on capital standards, premiums and logos. There is no reason to require the Bank System Chairman to develop a separate duplicate set of capital requirements and to worry about which standards are "less stringent" than those of national banks.

The Association favors an amendment to the bill providing that savings associations be subject to the uniform risk-based capital standards developed in accordance with the Basel Accord. Capital standards in accordance with the Basel Accord have been adopted by the Federal Reserve Board and are under consideration by the other banking agencies. This standard should include the 10-year goodwill write-off in the bill for capital computation only and not for financial and income statements. Such statements should be presented in accordance with GAAP. This 10-year period should be fixed by statute rather than permitting the Chairman of the Bank System to set a shorter period as provided in the bill.

The imposition of uniform risk-based capital standards would avoid the necessity for discriminatory deposit insurance assessments and separate logos. Most important, it would restore public confidence in the thrift industry, improve earnings, and preserve the value of the thrift charter.

We believe, also, that the new system would be even more efficient if the two existing insurance funds were combined into a single fund with a uniform logo and a single insurance assessment schedule. The bill would actually create three funds, the Bank Insurance Fund ("BIF"), the Savings Association Insurance Fund ("SAIF") and the Deposit Insurance Fund ("DIF"), which is a combination of the first two. A single fund would avoid the duplication of effort and added cost of administering these separate funds. The creation of a single fund would not require a commingling of bank and savings institution funds since separate accounts could be easily maintained on the books of one fund.

Irrespective of the structure of the new insurance system, and the kind of capital standards adopted, we believe that there is no economic justification for the imposition of a higher insurance premium on financially sound savings institutions, nor is there a justification for separate logos. These two subjects are discussed in greater detail below.

We support the transfer of the functions of the Bank Board to a new Bank System located in the Treasury Department under a single Chairman. This arrangement will inspire public confidence in the thrift industry. It has worked well for the Office of the Comptroller of the Currency ("OCC") and there has been no history of undue interference by the Secretary of the Treasury in the affairs of National banks. This arrangement is consistent with the goal of functional regulation and has the added advantage of permitting the resolution of overriding banking policy issues within a single Department in the Executive Branch.

IV.

Preserving the Value of the Thrift Charter

Mr. Chairman, the Administration's recovery program will be enacted in vain if the integrity and value of the thrift charter are diminished as a result of provisions which reduce thrift association powers directly or indirectly, or which lower earnings or the value of assets.

One proposal that would do this is in section 218 and 314 of the bill, which would require that savings associations deduct from their capital, loans and investments in, and "financial accommodations" to, subsidiaries (with the exception of those engaged solely in mortgage banking) that are engaged in activities that are not permissible for national banks.

This requirement would not only place healthy savings associations at a competitive disadvantage with commercial banks with regard to attraction of capital. This provision also

diminishes their investment powers indirectly by removing the economic incentive for associations to invest in subsidiaries engaged in activities inherent to the thrift charter.

The investment in a service corporation, like any other, is an asset in accordance with GAAP. Assets are carried on the books of a company at their full value unless impaired - in which case GAAP provides a procedure for writing them down.

The proposal in the bill would require associations to write down an asset - the equity investment in a subsidiary - to zero. By reducing the asset to zero, this proposal effectively reduces an association's power to engage in a covered activity.

Mr. Chairman, carrying this asset at zero would be the same as your buying a house with a mortgage equal to 80% of its value, and having the 20% equity deleted from your net worth!

We disagree with the assumption that impermissible national bank activities by definition involve a higher degree of risk than those that are permissible. Savings associations are authorized to engage in a wide variety of activities in service corporations. Many of these may well be less risky than those of national bank subsidiaries.

These determinations should be made on a case-by-case basis under the uniform capital rules that we have recommended be applied to thrift institutions.

The bill should require that all financial institutions immediately begin to report their financial condition in accordance with GAAP. Inconsistencies in the application of GAAP have developed in the regulatory agencies over the years and this has contributed to inconsistent reporting and the creation of some of the artificial preferences that we referred to earlier.

It is also essential that there be separate and distinct chartering, regulatory and supervisory apparatus for the savings industry and that the integrity of the Federal Home Loan Bank System be maintained. This is implicit in the bill, but we believe it should be made explicit.

Another problem is the proposed use of the capital of the Federal Home Loan Bank System to help fund the recovery. This capital represents a large percentage of the savings industry's net worth, and every dollar used for the recovery program is a dollar out of the net worth of the industry. This drain of the capital of the Bank System will lower the net earnings and therefore the value of the stock of the District Banks - stock that is owned by S&Ls.

The ongoing contribution by the Bank System should be limited to a fixed percentage of earnings and not to some arbitrary figure. We also question the advisability of allowing access to the District Banks' advance window by entities such as mortgage bankers and other financial institutions that are not thrift charters. We take this position because the expansion of access to the advance window would alter the unique characteristics of the thrift charter, and diminish its value and earning power.

To replace the dollars attributable to Bank System capital we would suggest that the Committee consider the imposition of fees on brokered funds. These funds enjoy the benefits of Federal deposit insurance but are not savings from an institution's community. Their availability in large amounts has contributed to the accelerated growth of many of the institutions that have failed in recent years. The brokers who supply these funds benefit from deposit insurance; there is no reason why they should not share the cost of this insurance.

Finally, we urge an amendment to the bill stating explicitly that goodwill created in a supervisory acquisition not be affected by the 10-year write-off provision in the bill. These acquisitions provided the FSLIC with assistance, both managerial and financial, during a period when both commodities were in short supply. The goodwill created was but one consideration in normally extremely complex transactions. The acquiring companies should not be punished for helping the FSLIC. The proposed voiding of contractual agreements concerning the disposition of goodwill will seriously harm companies who assisted the FSLIC.

V.

Thrift Holding Company Amendments

We fully support the amendments in the bill to the Savings and Loan Holding Company ("S&LHC") Act and to the Bank Holding Company ("BHC") Act. The proposal to permit bank holding companies to acquire healthy thrift institutions beginning two years after enactment of the bill would open up a significant source of capital for the thrift industry. We see no reason why banks and S&Ls cannot co-exist within the same holding company structure. The bill should make it clear, however, that an S&L that becomes part of a bank holding company may continue to exercise powers either directly or through a subsidiary that are authorized by the law and regulations of its Federal or State chartering authority. The Federal Reserve Board ("FRB") has recently proposed regulations asserting jurisdiction over these activities as conducted by state and national banks in a holding company. We would not like to see this happen to service corporations of S&Ls in a bank holding company.

The Savings and Loan Holding Company Act Amendments, which were enacted in 1967, have not been subject to a comprehensive review since then. The dramatic changes in the financial marketplace discussed in the preceding section of our statement have also rendered the S&LHC Act as outmoded in today's economic environment as many of the banking laws of the 1930's.

In adopting the S&LHC Act, Congress wanted to be sure that the deposits of and S&L would not be exposed to losses that might be incurred by the holding company parent or its non-S&L subsidiaries. The protections that were built into the law have served that purpose well. Experience has shown, however, that many of these restrictions are not only narrower than necessary for the protection of the S&L, but also diminish the value of its charter by imposing barriers to normal business transactions between the S&L and its affiliates.

The bill would repeal several of these restrictions most notable those on transactions with affiliates, debt approval and cross-marketing limitations.

All S&Ls would be subject to the transactions with affiliates rules of sections 23A and 23B of the Federal Reserve Act. These rules would permit holding company S&Ls to conduct normal business operations with its affiliates subject to an overall limit on covered transactions based on a percentage of capital and surplus, as well as "arm's length", safety and soundness and collateral requirements. The percentage of capital limits are 10% for any one transaction and 20% for all transactions. These are too low for thrift activities but section 23A authorizes an exemption of covered transactions and relationships from these limits upon finding by the FRB that the exemption is in the public interest and is consistent with the purpose of that section. The chairman of the Bank System would have this same authority.

Savings and loan holding companies are subject to debt restrictions which are far more burdensome than those applicable to bank holding companies. If adequate capital is to be infused into the thrift industry, and effective asset/liability management strategy is not to be inhibited, the restrictions on S&LHC indebtedness must be relaxed.

Present law provides that non-diversified S&LHCs and their subsidiaries can incur debt without the prior written approval of the Federal Home Loan Bank Board only to the extent that the aggregate indebtedness for which the holding company or subsidiary is liable would not exceed 15 percent of the net worth of such company at the end of the preceding fiscal year. Thus, without Bank Board approval, S&LHCs can incur very little debt. The statute clearly envisions Bank Board approval for higher debt levels, and provides a sixty-day limit on approvals, which can easily be extended. In any case, 60 days is too long a time to enable the applicant to take advantage of favorable market conditions. In today's capital markets, which are subject to sharp swings in interest rates, administrative delays in processing debt applications create a serious obstacle to debt financing.

These restrictions were considered necessary by Congress in 1967 in part because the Bank Board's power to enforce its orders were not as broad as they are now. These powers have been strengthened considerably since then and there is no reason to retain this outmoded restriction, which has no counterpart in the BHC Act.

The cross-marketing restrictions imposed on diversified S&L holding companies by the Competitive Equality Banking Act of 1987 ("CEBA") are justified by neither experience nor common sense. Thrift customers are protected from abusive marketing practices by both "anti-tying" and anti-trust laws. This limitation is an added disincentive for the acquisition of an S&L by companies that would become diversified holding companies as a result of the purchase.

We believe that these amendments are critical to the future health of the industry and urge their adoption.

The bill proposes two additional amendments that would delete outmoded restrictions on S&L holding companies. The first would permit an S&LHC to purchase up to 5% of the voting stock of an unaffiliated thrift or thrift holding company. Bank holding companies are permitted to invest in this manner, and this power has increased the depth of the market for the stock of these holding companies. It is our belief that this investment power will have the same effect on capital markets for S&L holding companies.

The second amendment would repeal a prohibition in the S&LHC Act against a director, officer or controlling person of an S&L holding company from serving, without FSLIC permission in a similar capacity with another S&L or S&LHC. Savings and loan holding companies are covered by the Depository Institutions Management Interlocks Act and there is no reason to subject these companies to duplicate sets of interlock restrictions.

Each of the thrift holding company sections I have just discussed was addressed in the "Thrift Charter Enhancement Act of 1988" as unanimously reported out by this Committee last year. We believe the reasons for approving these sections are even more compelling today.

VI.
Disincentives to Capital Investment in Thrifts

Mr. Chairman, the constructive solutions proposed by this bill are tempered, in our opinion, by three provisions that diminish the value of the thrift charter and hence the ability of the industry to attract capital.

The first problem has to do with the higher assessments proposed for institutions insured by the SAIF. We see no economic justification for a differential rate that will siphon funds from healthy thrifts that would otherwise be used to meet the new capital requirements. The higher SAIF rates will also put an S&L at a decided competitive disadvantage to commercial banks in both the consumer and the capital marketplace in attracting capital. Assuming the proposed assessment schedule goes into effect on July 1 of this year, a SAIF-insured institution would pay $38,000 per $1 million of deposits greater than that paid by a bank of the same size. These funds are best used for the building of capital.

Our second concern has to do with the proposed authority of the FDIC to raise insurance assessments by administrative action. Rates can be raised for either or both funds in specified cases, including net losses during any one of the prior three years, failure of either fund or the DIF to achieve target reserve ratios or if the FDIC determines that the fund will likely experience serious losses in the future due to extraordinary circumstances.

The authority for the FDIC to raise insurance assessments by administrative action is not consistent with the goal of attracting new capital to the thrift industry. A higher fixed insurance rate at least permits a prospective buyer to factor the rate into the calculation of an offer to purchase. The bill would grant the FDIC the power to raise the assessment to a maximum of 35 basis points (plus additional annual assessments to cover FDIC expenses). This is one basis point less than a 100% increase in the minimum SAIF rate and would have a chilling effect on prospective purchasers, creates substantial uncertainty for prospective buyers.

The Association proposes that this administrative authority be deleted from the bill and that a section be substituted providing that deposit insurance assessments may only be increased by Congressional authorization.

The third proposal that we believe would lessen the value of the thrift charter pertains to the display of the deposit insurance logo.

Section 218(1) of the bill amends section 18(a) of the

FDIC Act to provide that signs displayed by institutions relating to deposit insurance show whether the association is a member of the BIF or the SAIF. We believe that it would be more consistent with the Administration's objectives to amend this subsection to require a uniform logo stating that deposits are insured by the FDIC.

One of the causes of the premium that FSLIC-insured institutions are paying for deposits is the public perception that all such institutions are in financial difficulty. Replacing the FSLIC logo with one that is unfamiliar to the public but which implies that it is a successor to that agency will perpetuate, and possibly increase, the premium that S&Ls will have to pay in the future. This amendment would benefit commercial banks as well since they would continue to display a logo in which the public has confidence.

In summary, Mr. Chairman, we believe that this bill provides a constructive approach to the problems of the financially troubled segments of the savings industry, the federal deposit insurance funds, and related regulatory structure. Expeditious action must be taken now. The bill eliminates many of the restrictions in current law that are disincentives for the attraction of outside capital. Some provisions of the bill are counterproductive, and we have suggested alternatives. With the inclusion of these amendments which safeguard the value and integrity of the charter we support the bill.

This concludes our testimony, Mr. Chairman.

The CHAIRMAN. Thank you very much. We will come back to some of the items that you raised. I appreciate the detail of your statement.

Mr. Zwick.

STATEMENT OF CHARLES J. ZWICK, CHAIRMAN, SUBCOMMITTEE ON LEGISLATIVE AND REGULATORY ISSUES, ASSOCIATION OF RESERVE CITY BANKERS

Mr. ZWICK. Thank you very much.

Mr. Chairman, members of the committee, I am Charles J. Zwick, chairman and chief executive officer, Southeast Banking Corp., Miami, FL. I am appearing today on behalf of the members of the Association of Reserve City Bankers. I serve as chairman of the ARCB's Subcommittee on Legislative and Regulatory Issues.

The FSLIC/thrift industry crisis is the most important banking and financial issue of the moment. ARCB commends the committee for responding to this issue in a timely manner.

ARCB's position on this matter was adopted on January 31, 1989, prior to the announcement of the administration's proposal. Since then, important details about the administration's plan have been clarified, including assurances that increased deposit insurance assessments for banks will not be diverted into the thrift insurance fund or to the thrift industry.

In view of that, I am pleased to inform the committee today that the Association of Reserve City Bankers supports the administration's proposal. This assumes that certain key elements of the plan regarding insurance assessments for banks are in place.

We have ten points and I'll tick them off very quickly. The first is that the ARCB believes the current situation facing the thrift industry and FSLIC should be addressed at a very early date by the administration and the Congress and indeed that has taken place.

Second, it should be recognized that federal funding will be needed to solve the crisis facing the thrift industry. The crisis should not be solved by shifting the burden to any particular industry, and of course we feel strongly about the banking industry.

The FSLIC/thrift industry crisis is a national crisis that requires help at the national level. ARCB commends the administration for not seeking to shift the burden of funding to the banking industry.

Third, it would be unwise and unfair to tax bank deposits. Our economy needs more savings and investments, not less. Taxing savings is bad public policy. An increase in deposit insurance assessments is not desirable if not needed to keep the funds healthy.

ARCB supports the administration's plan provided the increased assessments are needed to make the proposed bank insurance fund financially sound and not for budgetary reasons. Indeed, we suggest that serious consideration be given to taking the bank insurance funds off budget so that it will become clear that deposit insurance assessments are proposed to make the fund sound rather than for budgetary reasons.

ARCB is strongly opposed to any merger of FDIC and FSLIC funds. The assets of the FDIC fund are required to maintain the strength of the banking industry. ARCB commends the administration for not recommending a financial merger of the two funds.

ARCB believes insolvent thrifts should be liquidated or otherwise disposed of in an orderly fashion as soon as possible to prevent the crisis from spreading further throughout the financial system. We have a major problem and time is running against us.

Next, healthy thrifts should be allowed to convert to FDIC insurance coverage provided they meet the same capital, tax, accounting and regulatory standards as banks. We believe that healthy thrifts, if they meet banking capital, tax, accounting and regulatory standards, should be allowed to convert to coverage under the proposed bank insurance fund.

While the administration proposal does not intend to eliminate all difference in standards between banks and thrifts, it moves in the right direction. Once these differences are eliminated, we see no reason why thrifts should not have bank insurance coverage.

We are also concerned about current regulatory treatment of credit unions. Much of this mirrors that of thrifts, and ARCB agrees with the administration proposal that reform of deposit insurance practices are needed at the credit union level.

Next, the business activities and regulatory burdens of banks and thrifts should be equalized. Bank holding companies should be allowed to acquire healthy thrifts. The administration's plan does not eliminate distinctions in the types of businesses that can be affiliated with thrifts and the types that can be affiliated with banks, a situation that will have to be rationalized in the future.

Bank holding companies should be allowed to acquire any thrift immediately without a 2-year wait proposed by the administration.

Serious consideration should be given to counting as capital the goodwill of the thrifts that banks acquire for a reasonable period of time. The treatment of capital at banks should be reexamined in light of the risk-based capital guidelines applied to banks and the need for capital in the thrift industry. Here as an aside I would say I agree completely with the comments of Senator D'Amato at the beginning and I gather supporting Senator Garn's earlier comments that the solution of this problem is to have banking organizations get into the thrift business with equal treatment. Under the administration plan we have more severe requirements than nonbanks.

Next, ARCB supports policies leading to more competitive opportunities in the financial marketplace. We support the legislation increasing competition in the financial services marketplace, such as adopted by the Senate in 1988.

We believe it was a lack of adequate supervision, not deregulation, that created the thrift problem.

Thrifts that are not insolvent or do not qualify for FDIC insurance should continue to be insured by FSLIC. Serious consideration should be given to administering the FSLIC fund within the FDIC and chartering and regulatory functions should be separated from the insurance function.

Last, immediate supervisory reform and federal funding are needed.

To summarize my summary, we have an immediate problem and the longer we wait, the more expensive it's going to be. Long-term we must reform the regulatory practices among the depository industries so that we have a consistent set of capital, accounting and regulatory policies.

Thank you very much.

[The complete prepared statement of Charles J. Zwick follows:]

STATEMENT
OF THE
ASSOCIATION OF RESERVE CITY BANKERS
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

MARCH 9, 1989

Mr. Chairman, members of the Committee, I am Charles J. Zwick, Chairman and Chief Executive Officer, Southeast Banking Corporation, Miami, Florida. I am appearing here today on behalf of the members of the Association of Reserve City Bankers (ARCB). I currently serve as Chairman of ARCB's Subcommittee on Legislative and Regulatory Issues.

About the Association

ARCB is an association of the highest-ranking executives from the nation's major banking institutions. Formed in 1912, ARCB has for three-quarters of a century been dedicated to the encouragement and development of sound business and banking principles; the analysis, discussion and action on important banking and financial issues; the identification of issues emerging in the economy and the financial system that will affect the business of banking and banking customers in the future; and the dissemination of accurate information and authenticated statistics on banking and financial matters of interest to the members of ARCB and the public in general.

ARCB Position on FSLIC/Thrift Industry Crisis

The Association of Reserve City Bankers (ARCB) appreciates this opportunity to present its views to the Committee on Banking, Housing and Urban Affairs of the United States Senate on the crisis facing the Federal Savings and Loan Insurance Corporation (FSLIC) and the thrift industry. The FSLIC/thrift industry crisis is the most important banking and financial issue of the moment facing policy-makers in banking and holders of public office. ARCB commends the Committee for responding to this issue in a timely manner.

The FSLIC/thrift industry crisis is of profound interest to ARCB and its members. The matter is of such interest and concern that in late 1987 ARCB commissioned a study of the implications of the FSLIC/thrift industry crisis for banking to be conducted by the law firm of Arnold & Porter and consultants at the

Secura Group.[1] While this Report to ARCB represented the views of the authors and did not represent an official statement of policy for ARCB, it was a useful document in providing background information on the crisis for banking policymakers. It also offered a number of proposals for the consideration of ARCB members in addressing the crisis.

A major conclusion of the Report was that estimates of the size of the problem facing FSLIC and the thrift industry was much larger than officially recognized at the time, and consequently the amount of federal funding that would be needed to solve the crisis was significantly larger than expected. The Report estimated the cost to be in the range of $35 to $64 billion. Those estimates turned out to be more accurate than official estimates, which at that time were as low as $15 billion.[2]

The estimates contained in the Arnold & Porter/Secura Group Report are closer to what the administration now estimates to be the current dimensions of the crisis, if the fact that the dimensions of the crisis have grown since Arnold & Porter and Secura Group Report was published, which certainly appears to be the case. The implication was that federal funding would be needed to solve the crisis.

This Report was also helpful in outlining some of the major causes of the FSLIC/thrift industry crisis. We have attached that part of the Arnold & Porter/Secura Group Report dealing with these matters, particularly those dealing with the federal regulation of thrifts, as Appendix A to our statement.

This past Fall, ARCB also commissioned the firm of Peat Marwick Main & Co to research the legislative history of the FSLIC and the Federal Deposit Insurance Corporation (FDIC). The primary focus of this effort was on the legislative history of the establishment and maintenance of the FDIC and FSLIC insurance systems as two separate insurance systems.[3]

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[1] Arnold & Porter and the Secura Group, Implications for the Banking Industry of the Financial Condition of the FSLIC and the Thrift Industry, A study for the Association of Reserve City Bankers, April 1988; hereafter referred to as Report.

[2] Testimony of M. Danny Wall before the Subcommittee on General Oversight and Investigations, Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, February 4, 1988; cited by Arnold & Porter and the Secura Group, Report, p. 48.

[3] Peat Marwick Main & Co, The Establishment and Maintenance of the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation as Separate Deposit Insurance Systems: A Legislative History, a paper prepared for the Association of Reserve City Bankers, January 16, 1989.

The paper prepared by Peat Marwick Main & Co for ARCB is attached to this statement as Appendix B. This paper suggests that Congress, in creating the two separate insurance funds of the FDIC and the FSLIC, never intended there be a merger of the funds, nor did it intend for one fund to raid the other, in the event one of the funds should experience financial difficulties.

This past Fall, ARCB's Government Relations Committee directed its Subcommittee on Legislative and Regulatory Issues to develop a statement of position for ARCB on the FSLIC/thrift industry crisis. The Subcommittee completed its work shortly thereafter, and its proposed statement of position was formally presented to ARCB's Board of Directors and membership at ARCB's Midwinter Meeting here in Washington, D.C., January 28-31, 1989. The Board of Directors formally approved the position statement on January 31, 1989 as ARCB policy.

ARCB's position statement on the FSLIC/thrift industry crisis was presented to members of Congress, administration officials and the banking regulators during ARCB's Midwinter Meeting. It is important to note that the position statement was approved by ARCB's Board of Directors in the midst of the development of a final position on the crisis by the administration. Details of the administration's proposal were not known at that time. Many details of the proposal have become clear only recently.

The views of ARCB presented to the Committee on Banking, Housing and Urban Affairs today are based on the ARCB position statement as adopted January 31, 1989, when the administration's proposal was still in its formative stages. Since then, the plan has been presented to the public and important details about the plan have been clarified. Importantly, there are assurances from the administration that increased deposit insurance assessments for banks will not be diverted to FSLIC or to the thrift industry. ARCB would have to oppose the plan if that had that been proposed.

Now that the plan has been put forward and important details about it are known, including the disposition of increased insurance assessments from banks, I am pleased to inform the Committee that the Association of Reserve City Bankers (ARCB) supports the administration's proposal.

This assumes that certain key elements of the plan regarding insurance assessments for banks remain in place. This would mean that the limits on assessments for banks of 12 basis points and ultimately 15 basis points should not be exceeded. We are concerned that the insurance assessment rate could range as high as 35 basis points under certain circumstances. Rebates to banks should be achieved once the desired ratio of balances in the proposed Bank Insurance Fund to insured deposits is reached. Insurance assessments on banks for the Bank Insurance Fund should not depend under any circumstances on the condition of the insurance fund for thrifts.

ARCB's statement of position as it was adopted on January 31, 1989, on the basis of information available at that time, is reproduced in full on page 6.

The remainder of our statement is directed to the administration's proposal for solving the FSLIC/thrift industry crisis, as we now understand it. We have addressed the various elements of that proposal in the context of each of the above points in ARCB's position statement.

Position of ARCB on FSLIC/Thrift Industry Crisis[4]

The Association of Reserve City Bankers (ARCB) believes the current situation facing the Federal Savings and Loan Insurance Corporation (FSLIC) and the thrift industry should be addressed at a very early date by the administration and the congress.

It should be recognized that federal funding will be needed to solve the crisis facing FSLIC and the thrift industry. The crisis should be solved through funding out of the federal government's general revenues. The burden of the crisis should not be shifted to any particular industry, particularly the banking industry.

It would be unfair and unwise to tax bank deposits. Our economy needs more savings and investments. Taxing savings is bad public policy. An increase in deposit insurance assessments is not desirable nor is it appropriate at this time.

ARCB is strongly opposed to any merger of the FDIC and FSLIC funds. The assets of the FDIC fund are required to maintain the strength of the banking industry.

ARCB believes insolvent thrifts should be liquidated or otherwise disposed of in an orderly fashion as soon as possible to prevent the crisis from spreading further throughout the financial system.

Healthy thrifts should be allowed to convert to FDIC insurance coverage providing they meet the same capital, tax, accounting and regulatory standards as banks.

The business activities and regulatory burdens of banks and thrifts should be equalized. Bank holding companies should be allowed to acquire healthy thrifts.

ARCB supports policies leading to more competitive opportunities in the financial marketplace. Banking and the financial system should not be reregulated because of the thrift crisis. It was a lack of adequate supervision not deregulation that created the thrift problem.

Thrifts that are not insolvent or do not qualify for FDIC insurance should continue to be insured by the FSLIC. Serious consideration should be given to administering the FSLIC fund within the FDIC, and chartering and regulatory functions should be separated from the insurance function.

Immediate supervisory reform and federal funding are needed. ARCB stands prepared to work with the new administration and the congress in addressing these matters.

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[4] Approved by the Board of Directors of the Association of Reserve City Bankers, January 31, 1989.

The Need to Address the Issue

The Association of Reserve City Bankers (ARCB) believes the current situation facing the Federal Savings and Loan Insurance Corporation and the thrift industry should be addressed at a very early date by the administration and the congress.

The Association of Reserve City Bankers commends the administration for having put forward at an early date a detailed plan for addressing the FSLIC/thrift industry crisis. An early resolution of the crisis is needed to prevent it from spreading elsewhere in the financial system, from possibly undermining confidence within the financial marketplace and from increasing the ultimate costs to the federal government. ARCB believes congress should also move quickly to address this matter for these same reasons.

Particularly important, of course, are assurances to depositors that their insured deposits are safe. A sharp difference will need to continue to be made between the safety of depositors' insured funds and the safety of any given institution. One of the major problems in the thrift industry has been the perpetuation of insolvent institutions at a great cost to society, whereas the correct focus should have been on the protection of depositors' funds and not the depository institutions, their management or shareholders in troubled situations.

It is also important that legislation to resolve the thrift crisis not be encumbered by provisions extraneous to a prompt resolution of the thrift crisis. The inclusion of extraneous or additional matters of controversy may work against an early resolution of the thrift crisis, thus adding to the ultimate cost for the federal government. We note in particular the numerous issues relating to the issue of deposit insurance reform which the administration is recommending be part of a study to be completed 18 months after the date of enactment of the thrift rescue package.

The issue of deposit insurance reform is an important one to members of ARCB. Those elements of reform essential to an early resolution of the thrift crisis, however, appear to have been addressed at this time in the administration's plan. Others, such as those to be included as part of the study, should be dealt with later, after they have been given the attention and study they deserve.

Funding a Solution to the Crisis

It should be recognized that federal funding will be needed to solve the crisis facing FSLIC and the thrift industry. The crisis should be solved through funding out of the federal government's general revenues.

The FSLIC/thrift industry crisis is a national crisis that requires a national solution. To the extent that the thrift industry itself can help to fund a solution to the crisis, it should be required to do so. In the end, however, it is widely recognized that a solution will involve funding by the federal government. The administration's proposal wisely recognized this to be the case. In doing so, it avoided shifting the burden to other groups or industries, outside that of the thrift industry. ARCB is particularly supportive of efforts not to expect the banking industry to fund a solution through the FDIC deposit insurance fund or directly through explicit or implicit taxes other than those the industry would pay because of its obligation as a general taxpayer under current law.

The rationale for a public solution to the crisis has to do with the reasons for the crisis and expectations at large that public funding would be necessary in the event of a crisis of the proportions entailed in that of the thrift industry today. The legislative history of FDIC and FSLIC suggests that Congress envisioned public funding in the event of such an emergency (see Appendix B to this statement for a discussion of this point in the legislative history of FDIC and FSLIC).

The causes of the crisis are several and, by now, fairly well known: a downturn in certain sectors of the economy and in certain regions of the country, inadequate supervision and examination, poor management or ill-conceived operating practices and lending abuses and fraud. It is worth noting that the causes for the crisis occurred within the thrift industry, and to a large extent they were, therefore, under the control of institutions operating in that industry and the regulators, or the causes were outside the control of those institutions and the industry in general because they were operating in the economy at large. This suggests that the responsibility for funding a solution belongs with the thrift industry or the federal government.

The primary or single most important cause of the crisis is perhaps difficult to pinpoint with great precision. That's because seemingly-independent reasons are interrelated. But, one important factor contributing to the crisis has been a set of public policies directed toward the thrift industry, and operating in favor of it, as a specialized residential mortgage lender. As noted in the Arnold & Porter/Secura Group study:

> [T]he impetus for federal regulation of the savings and loan industry has always been the promotion of home ownership. All of the federal thrift legislation enacted in the 1930's had the express function of ensuring the availability of home mortgages.[5]

These policies took the form of a set of subsidies, protection and supports for the thrift industry with the ultimate goal and objective of fostering homeownership. In saying this, we wish to make it absolutely clear that we are not questioning here the underlying public policy of promoting homeownership.

What is being questioned, however, is the pursuit of such policies through specialized mortgage lending institutions. These institutions were unable to operate in an inflationary or unstable economic environment, and ultimately they had to rely on government forbearance and other regulatory stopgaps to continue to remain in operation. It is not public policies toward housing, but rather the pursuit of such policies through specialized mortgage lending institutions, that has brought us to the unfortunate condition the thrift industry and the nation finds itself in today. We believe it important to note that financing for housing is being made available from a wide range of sources today, and bank financing for the residential housing market has grown significantly in recent years.

As well intended as they may have been, public policies toward thrift institutions as specialized residential mortgage lenders were ill-suited for fostering homeownership during periods of rapid inflation and high interest rates, such as we experienced during several past economic cycles, but most recently in the early 1980's. As the Arnold & Porter/Secura Group Report notes:

> Thrifts, by law, had focused their lending efforts on long-term, fixed-rate mortgages and supported these assets primarily with short-term deposit liabilities. As interest rates rose in the late 1970's, immediate pressure was placed on liability costs while the longer-term assets were slow to reprice...These rate mismatches had the expected impact on earnings [of thrifts].[6]

Chairman Greenspan of the Federal Reserve Board expressed a similar point of view when he appeared before this Committee recently and noted that:

> Today's thrift industry losses grew partly out of the vulnerability of a fixed rate, long-term, lender with relatively short-term liabilities, to changes in interest rates. As inflation, and interest rates, rose in the late 1970's and early 1980's,

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[5] Arnold & Porter and Secura Group, Report., pp. 17-18.

[6] Arnold & Porter and the Secura Group, Report, pp.35-36.

and as deposit rate ceilings were phased out, the resulting mismatch of the rising costs of deposit liabilities and the fixed return on mortgage assets produced substantial losses and a serious erosion of industry capital.[7]

Many observers believe this erosion of capital encouraged some managers to thrifts to take undue risk and engage in questionable practices. For example, Professor Stuart Greenbaum of Northwestern University has stated to this Committee last May that:

> "...what we had here were institutions that were stripped of their capital because of the inflation of the seventies and the inversion of the yield curve in 1980 and 1981. So we had many institutions out there who no longer had their own capital in the business. Their attitudes toward risk-taking were transformed by that experience."[8]

R. Dan Brumbaugh, Jr., who has written extensively about the thrift industry crisis, also has notes that:

> This [shift in monetary policy in 1979] contributed to a spike in interest rates that led to an unprecedented increase in thrifts' cost of funds, which rose from under 9 percent in 1980 to more than 11 percent at the end of 1981, with almost no corresponding increase in revenues due to the preponderance of fixed-rate mortgages being held.
>
> This was the beginning of the modern thrift crisis.[9]

Fraud and mismanagement are also cited quite frequently for being in evidence in most instances of troubled or failing thrifts. Even the regulators have acknowledged their capabilities were stretched thin. Their ability to catch fraudulent or illegal activities was particularly poor. We cover this point later in our statement.

The point of all this is that the difficulties facing FSLIC and the thrift industry were brought on by a series of factors both within and outside the thrift industry. To the extent that those problems can be solved by the thrift industry, they should be. The thrift industry, of course, does not have the resources to cover aggregate exposures to insured depositors at thrifts. And, to the extent that it cannot cover those exposures, they will have to be covered by the federal government.

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[7] Statement of Alan Greenspan before the Committee on Banking, Housing and Urban Affairs, February 23, 1989, pp. 2-3.

[8] Hearings, p. 212.

[9] R. Dan Brumbaugh, Jr., Thrifts Under Siege, Ballinger Publishing Company, 1988, p. 15.

This is the cost to society at large for policies designed to encourage homeownership through specialized lending institutions and lending arrangements. It is a cost that society must now be asked bear. As Martin Feldstein, former Chairman of the Council of Economic Advisers, noted recently: "the outlays are essentially only a formal recognition of government liabilities that already exist."[10]

To the extent that policies encouraged houses to be built and created a nation of homeowners, they were successful and the costs to society at large may be worth the adoption of such policies. Those policies were adopted and pursued with the best of intentions, but they nonetheless were costly and, in the end, ill-suited for depository institutions in our economy today.

This experience illustrates severe drawbacks in the forced specialization of depository institutions in our economy. It also suggest that better ways should be found to more subsidize housing. It would be preferable, for example, to place the subsidy for housing finance directly on the mortgage financing instrument itself, rather than indirectly on one type of institution that is expected to support the housing market. That way, all depository institutions would be encouraged to support the housing market, not just one particular type of institution. Not only would this help to broaden the mortgage financing market, but each institution would be better able to adjust its balance sheet to remain viable as market conditions changed.

We note that the administration's rescue plan does not particularly alter the fundamentals of a specialized lending institution as part of public policy. We note that the so-called qualified thrift lender test (QTL) is retained, for example, and that thrifts meeting such a test would still be entitled to subsidized lending from the Federal Home Loan Banks and tax benefits not accorded other mortgage lending institutions such as banks. Basically, this is a test of an institution's commitment to residential mortgage financing. As long as this test remains in place, banks meeting it should be accorded similar access to the Federal Home Loan Bank system and tax treatments.

As Chairman Greenspan's testimony before this Committee noted, the mortgage market has changed dramatically in recent years, and the role of other lenders in this market should be included as part of the study of deposit insurance reform envisioned under the administration's proposal. Chairman Greenspan, as you know, said:

> This new environment may make it unnecessary to provide special government subsidized facilities for mortgage lending, and may make it possible to eventually bring all depository institutions under one regulatory and supervisory

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[10] Martin Feldstein, "FSLIC Funding Belongs Off-Budget," The Wall Street Journal, March 1, 1989, p. A14.

system. This issue should be given priority attention as part of the study of deposit insurance reform.[11]

Public funding of the thrift crisis can also be justified in light of public policies designed to instill depositor confidence and insure deposits at the nation's depository institutions. That commitment went above and beyond what the insurance funds are capable of handling in a crisis, as the legislative history of the FDIC and FSLIC makes clear.

Clearly, the deposit insurance system of FSLIC is not adequate to handling a crisis of the current proportions facing the thrift industry. It appears to have been understood that, as important as the insurance funds may have been in supporting depositor confidence and handling failed institutions under most circumstances, balances in the Fund would not replace direct public funding in the event an emergency of substantial proportions were to arise. We refer the Committee to the report on the legislative history of the FDIC and FSLIC deposit insurance funds, attached as Appendix B to this statement, for a further discussion of this point.

The point of all this is to suggest that public funding for the crisis facing FSLIC and the thrift industry is rational, certainly to the extent that the crisis cannot be handled by the thrift industry or FSLIC. Chairman Greenspan of the Federal Reserve Board addressed this matter when he appeared before this Committee recently and noted that:

> The reason for public expenditure to support deposit insurance is the basic benefits to the economy as a whole that we derive from deposit insurance...Losses of the kind that we face today should not happen, but with the gain to society as a whole that come with deposit insurance we must accept both the possibility and the reality that there will be losses to be borne by society as a whole.[12]

We believe the administration's emphasis in placing the funding solution on the thrift industry, to the extent that is possible, and to public monies is appropriate.

Burden of the Crisis

The burden of the crisis should not be shifted to any particular industry, particularly the banking industry. It would be unfair and unwise to tax bank deposits. Our economy needs more savings and investment. Taxing savings is bad public policy.

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[11] Statement of Alan Greenspan before the Committee on Banking, Housing and Urban Affairs, United States Senate, February 23, 1989.

[12] Statement of Alan Greenspan before the Committee on Banking, Housing and Urban Affairs of the United States Senate, February 23, 1989, p. 11.

ARCB is pleased the proposal put forward by the administration does not put the burden directly on depositors and savers at banks and other depository institutions. A direct tax on deposits and savings could easily have been a disincentive to savings, which would be particularly troublesome at a time when the savings rate in this country is historically low and increased savings is needed. If not a disincentive to savings in the aggregate, such a tax would certainly have been a disincentive to savings at those particular types of institutions whose depositors were being asked to bear the tax.

The tax on deposits would have been an extension of policies designed to achieve a particular set of public objectives (in this case, to fund the thrift crisis) through a particular institutions, much the same way the housing objectives of public policies were designed to achieve a housing objective through the thrift institutions. Mutual funds, for example, would not have been included. Such a policy would have been ill-suited in today's economy, particularly in view of the sensitivity that savers have today to yields in the financial marketplace and the large number of competitive alternatives they have other than insured depository institutions.

ARCB supports efforts not to shift the burden for the thrift industry crisis to the banking industry.

Deposit Insurance Funds

An increase in deposit insurance assessments is not desirable nor is it appropriate at this time. ARCB is strongly opposed to any merger of the FDIC and FSLIC funds. The assets of the FDIC fund are required to maintain the strength of the banking industry.

ARCB strongly opposes any merger of the FDIC and FSLIC insurance funds. ARCB also opposes any proposal that would allow balances in the bank insurance fund to be used for solving the FSLIC/thrift industry crisis.

This is, of course, not part of the administration's plan, and the proposal put forward by the administration makes that quite clear. Even if such a proposal had been put forward and accepted, it is clear that it would not have been a practical solution since the FDIC fund is inadequate for this purpose and its use to that end may undermine confidence in the banking system, and were they diverted to the thrift industry they would only have to be replaced. A merger of the funds is not only opposed by the banking industry, it has been recommended against by the General Accounting Office (GAO) and the Federal Deposit Insurance Corporation (FDIC).

We note to the Committee that the legislative history of the FDIC and FSLIC never envisioned a merger of the funds or the raiding of one fund to assist the other as an option in the event of financial difficulties. Indeed, there is evidence, as noted in the paper by Peat Marwick Main & Co contained in Appendix B to our statement, that members of Congress did not intend balances in one fund to be available to the other under any circumstances. That paper concluded that:

> Of significant importance were statements made during the debate on the Federal Deposit Insurance Act of 1950 concerning the possibility that the very healthy FDIC reserve might be "raided" by the federal government, if they were allowed to grow much larger. These statements (and subsequent Congressional approval of a premium rebate system for FDIC members) imply a Congressional intent that the FDIC fund should not be used by the federal government for purposes other than the insurance of FDIC members' deposits. The preservation of the FDIC's integrity was regarded by some members as a "sacred trust." Under no circumstances were its reserves to be "raided" for other uses.[13]

Congressman Paul Brown of Georgia, a senior Democrat on the House Banking Committee, was particularly eloquent on the subject in arguing that:

> [I]t's [FDIC insurance fund] safety or guardianship is a sacred trust. We must always be aware of any attempt to raid this fund either directly or indirectly, such as attempting to alter in any way the independent status of the FDIC (underlining added for emphasis).[14]

The administration's proposal honors this "sacred trust." It does not propose to merge the funds, nor does it envision using bank insurance premiums to fund the FSLIC crisis. As Treasury Secretary Brady told this Committee last month: "not one penny from commercial banks will go to any S&L resolution or to the new savings association insurance fund." An outline of the administration proposal dated February 14, 1989 states that the FDIC "would maintain the existing FDIC and the FSLIC funds as separate insurance pools that could not be commingled."[15]

ARCB strongly recommends that the Committee include language in the legislation it adopts to implement the administration proposal that specifically recognizes and reaffirms the historical separateness of the insurance funds for banks and thrifts.

The most troublesome aspect of the administration's rescue plan is the increase in deposit insurance assessments contemplated for the banking industry. The increase in assessments has been made an integral part of that plan.

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[13] Peat Marwick Main & Co, Legislative History, p. 15.

[14] Peat Marwick Main & Co, Legislative History, p. 15.

[15] Outline of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, February 14, 1989.

There are several reasons why this proposal is troublesome. For one thing, current budget practices make it unclear whether the increase in deposit insurance premiums is needed to make the bank insurance fund financially sound or whether it is needed as revenue to offset expenditures for the FSLIC/thrift industry rescue plan. And, of course, at the time ARCB adopted its position statement, it was unclear whether or not the increased deposit insurance assessments for banks would be diverted into the thrift insurance fund. A great deal more is now known about the administration plan than was the case when ARCB's position statement was adopted.

Since then, the concept of a tax on bank deposits has been dismissed. The proposal to raise FDIC insurance assessments for bank, however, remains. Assurances have been forthcoming that increased assessments on banks not be used to fund the FSLIC/thrift industry crisis. Treasury Secretary Brady, for example, in introducing the administrations proposal to Congress, has said that "premiums from each industry will be used only for its own insurance fund." FDIC Chairman Seidman has said also that "the revenues generated from these premiums will go solely to build the FDIC fund."[16]

At the same time, it is appropriate to ask whether or not the increase in deposit insurance assessments for banks would have been included as part of the plan had the budget impact not been quite so favorable. We note that one year ago, Chairman Seidman of the FDIC reported to this Committee that the FDIC insurance fund was "strong and stable," and that, even if there were a decline in the fund, Chairman Seidman said "we believe the FDIC fund is sufficient to deal with any problems we can foresee in the banking system."[17]

Admittedly, that was before many of the most troublesome problems in Texas had finally become evident and in need of funding. But, as recently as this past November, Chairman Seidman said that even with the Fund declining to $15 billion by year end 1988, "[w]e are in a position to handle the problems we can foresee."[18]

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[16] Testimony of Nicholas F. Brady before the Senate Committee on Banking, Housing and Urban Affairs, United States Senate. February 22, 1989; and Testimony of L William Seidman before the Committee on Ways and Means, United States House of Representatives, February 22, 1989. See also outline of the financial institutions reform, recovery, and enforcement act of 1989, dated February 14, 1989.

[17] FDIC, News Release, May 25, 1988; See also testimony of L. William Seidman, Hearings, Oversight on the Condition of the Financial Services Industry, Committee on Banking, Housing and Urban Affairs, United States Senate, May 25, 1988, pp. 24-25.

[18] L. William Seidman, Deposit Insurance for the Nineties, remarks before the National Press Club, November 30, 1988.

To be fair, Chairman Seidman did state last May that the Fund was not increasing at a rate commensurate with bank deposits. There was no call then, however, to increase the size of the Fund by raising deposit insurance assessments on banks. Only recently, in the context of a study on deposit insurance by the FDIC, has the FDIC raised the issue of having the FDIC act as a real insurer by being able adjust premiums to reflect experience and costs on a continuing basis.

The administration, of course, has raised the proposal for increasing bank insurance assessments as a component of its rescue plan for the thrift industry. We note in this regard that FDIC Chairman Seidman recently called for deposit insurance systems to be separately budgeted, and not be included as part of the regular federal budget. We believe such a move is extremely important. Chairman Seidman's reason for this recommendation was that:

> [T]he federal budget system works backwards for an agency mandated to save for emergencies. For decades the FDIC has been depositing its unspent premium income in the Treasury. We received no taxpayer's funds. Are these deposits counted as savings? No, they are counted as income to the government rather than savings put aside for a rainy day. When it comes time to make a withdrawal to deal with a banking problem, that action is treated as government expenditure. It should be treated as a payback of money on deposit [underlining in original text].[19]

Unfortunately, we face a situation today where budgetary practices for the U.S. government may be driving public policy toward an increase in deposit insurance assessments at banks. That would indeed be unfortunate. But, it is unclear that this is the sole motive behind the administration's recommendation because the increase in insurance assessments for banks has also been justified on the grounds that the current ratio of balances in the FDIC insurance Fund to insured deposits is relatively low and needs to be raised.

On February 22, 1989, FDIC Chairman Seidman told the House Ways and Means Committee that at year-end the FDIC insurance fund's reserves will be reduced to 83 cents per $100 of insured deposits. Federal Reserve Board Chairman Greenspan has joined Chairman Seidman in saying the trend here should be reversed as a "necessary step to maintain the integrity of the FDIC fund against future contingencies. Treasury Secretary Brady has said the increase is necessary to "bring the FDIC fund back in line with its historical reserve-to-deposit ration to protect depositors and taxpayers."[20]

Whatever the reason, however, counting increased deposit insurance assessment revenue as federal budget receipts has a clear drawback if the balances in the FDIC fund are needed to assist with troubled banks, since this will be registered as an expenditure under in the federal budget and result in an increase in the federal deficit. Conceptually, the funds will not be needed immediately, and thus the increase will serve the practical purpose of offsetting outlays in the federal budget for the resolving the thrift crisis. This only raises a question of whether such an increase is, therefore, appropriate or necessary. If not, the only reason to raise assessments would be solely as an offset to the budgetary impact of the thrift rescue plan, which we would question as an appropriate public policy on which to base increases in deposit insurance assessments.

We note that the ratio of the FDIC deposit insurance fund to insured deposits at all commercial banks has declined somewhat in recent years. In spite of this, it is legitimate to ask at what level the insurance fund becomes adequate. Historical ratios may be useful, but they may also be misleading if historically high ratios were unneeded, as they were throughout most of the FDIC's history.

In view of all this, it is reasonable to question the appropriateness of seeking to achieve a ratio for balances in the insurance fund relative to insured deposits specifically as high as 1.25 percent. In addition, it seems reasonable to ask that once a desired ratio is achieved, whatever it may be, that either rebates on assessments actually take place or, alternative, insurance assessment rates be lowered. Furthermore, it also seems reasonable to ask that assessments on banks be sought only if a finding is made that they are absolutely necessary to maintain the fund's financial soundness.

We note that the ratio of FDIC balances ranged as high as 1.96 percent of insured deposits during the early 1940's, a period when the number of bank failures was relatively small. Historically high ratios of the fund to deposits resulted in rebates up until a few years ago because it was felt the fund was larger than need be. Only in the last several years, as the demand on the fund has risen, have questions about its adequacy been raised and, only in the context of the administration's new proposal have proposals arisen for actually increasing the fund through new insurance assessments on bank deposits.

It should be noted that the legislative history of the FDIC and FSLIC, included as Appendix B to this statement, suggests that the funds were never intended to cover a major crisis. The legislative history suggests that discussions focused on the possibility of financial assistance from the federal government should the resources of the FDIC be insufficient to weather a full scale crisis. Apparently, Congress concurred with those who contended that even an FDIC with realistically large reserves probably would still require federal government assistance in the event a crisis should occur (see Appendix B to this statement).

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[19] Ibid., p. 5.

[20] Testimony of L. William Seidman before the Committee on Ways and Means, United States House of Representatives, February 22, 1989; Statement by Alan Greenspan before the Committee on Banking, Housing and Urban Affairs, United States Senate, February 23, 1989; Testimony of Nicholas F. Brady before House Committee on Banking, Housing and Urban Affairs, United States Senate, February 22, 1989.

We draw the Committee's attention also to the increase in capital that has occurred at banks in recent years. Equity capital at all commercial banks increased from $126.7 billion at the end of 1982 to $181.3 billion, or almost $55 billion, by the end of 1987.[21] Reports are that banks also increased their equity capital position substantially in 1988.[22] Equity capital has tended to keep pace with the growth in insured deposits, with the ratio of equity capital to insured deposits remaining around 11 percent in recent years--11.2 percent at the end of 1982, for example, compared with 10.9 percent at the end of 1987. Bank capital is also expected to increase in the future under the newly-adopted Risk-Based Capital Guidelines adopted by the bank regulatory agencies.

This capital position of banks provides a significant cushion within commercial banking to deal with unforseen contingencies. The $15 billion or so in social capital at the FDIC--the balances held in the FDIC deposit insurance fund--represents a solid addition to private capital--capital held on the books of commercial banks--to be used in the event of financial difficulties at banks should they occur in the future. The social capital fund, of course, will also grow as interest on balances in the FDIC fund continue to be added to the aggregate. These interest payments and their compounding will represent a significant addition to the bank insurance fund during the period ahead.

Statements by the administration that the increased insurance assessments on banks will not be used to fund the thrift insurance fund, are assuring. Of some comfort, also, are assurances that the FDIC and FSLIC insurance funds will not be commingled. It would be helpful, however, if the legislation that is adopted included certain other assurances to address questions we have raised.

As we noted earlier, a specific provision to maintain the historical separateness of the bank and thrift insurance funds should be written into law. This appears to have been the legislative intent of congress, and it should be made explicit.

Another important provision would be one providing assurances that bank insurance assessments will not depend on the condition of the thrift insurance fund, or the new Savings Association Insurance Fund, as it would be called. Behavior in the thrift industry or the condition of the thrift insurance fund should not be a factor in determining the adequacy or inadequacy of the Bank Insurance Fund, since the two funds are intended to be separate and not commingled. We express concern in this area, because the legislation proposed by the administration is unclear on this point.

As drafted, the legislation could be interpreted to allow insurance assessments on banks to be increased if the thrift insurance fund, or the aggregate of the two funds, should fall below specified minimums. Specifically, it appears to permit the FDIC to raise assessments above the rates otherwise established by the legislation if the reserve ratio of the bank and thrift funds--the proposed Deposit Insurance Fund (defined as comprising the bank and thrift funds)--falls below 1.20 percent, or if "extraordinary circumstances" arise that "raise a reasonable risk of serious future losses" to either of the Bank Insurance Fund or the Deposit Insurance Fund.

Although the bill (S. 413) does outline procedures relating to the FDIC's ability to raise bank assessment rates, the language appears to permit the FDIC to raise the assessment rate on banks to compensate for any harm suffered by the Deposit Insurance Fund as a result of losses incurred by the insurance fund for thrifts. The result of such a provision would be to force banks to bear the burden of the thrift industry's losses, in clear contradiction to the traditional separation of bank and thrift deposit insurance funds. ARCB is strongly opposed such a provision, and the legislative provision on this subject needs to be clarified to make certain that the bank insurance assessments do not depend on the condition of the thrift insurance fund.

Another important provision would be one making it clear that a lower annual assessment rate for banks would actually occur if the bank insurance fund has a reserve ratio greater than 1.25 percent. We are concerned over the discretion provided in lowering the assessment rate or providing rebates on assessments, particularly so long as the bank insurance fund remains on budget.

Bank insurance assessments should not exceed the planned 12 basis points and ulitmately 15 basis points. We note also that the legislation provides for a maximum annual assessment rate of 35 basis points, which we understand could be imposed under certain conditions. We have serious reservations about an annual assessment rate at such a high level. Our concerns are heightened particularly in view of the legislative history showing that the deposit insurance funds were never intended to deal with the type of emergencies such a high level of annual assessments apparently contemplates.

Serious consideration should be given to taking new Bank Insurance Fund off budget. This would assure the banking industry that insurance assessments are being proposed to make the Bank Insurance Fund financially sound and make it clear they are not being sought for the potential impact they might have in reducing the federal deficit. Serious consideration should be given to removing the insurance funds from budget constraints in hiring qualified examination and supervisory personnel.

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[21] Federal Deposit Insurance Corporation, Statistics on Banking, 1987, Table RC-9, p. 42.

[22] "Capital Levels at Big Banks Improved in '88," American Banker, February 23, 1988, p. 1.

Liquidation of Insolvent Thrifts

ARCB believes insolvent thrifts should be liquidated or otherwise disposed of in an orderly fashion as soon as possible to prevent the crisis from spreading further throughout the financial system.

ARCB commends the administration on the quick action it has taken in addressing in particular insolvent thrifts. Our understanding is that the plan envisions spending $50 billion dollars to resolve those institutions that are currently insolvent or others that are marginally solvent but may become insolvent over the next several years. The plan also calls for the creation of what is known as a Resolution Trust Corporation (RTC) to oversee the resolution of all thrifts that are now insolvent under Generally Accepted Accounting Practices (GAAP) or will become so over the next three years.

ARCB believes the administration's proposal for dealing with insolvent or nearly insolvent thrifts in a timely manner is extremely important, and it encourages Congress to act promptly on this matter.

Healthy Thrifts

Healthy thrifts should be allowed to convert to FDIC insurance coverage providing they meet the same capital tax accounting and regulatory standards as banks.

As we understand the administration's proposal, all thrifts would be required to meet the capital standards applicable to national banks by 1991. Thrift Regulatory Accounting Practices (TRAP) practices can no longer be an acceptable accounting practice. We note also that the FDIC will be given enhanced regulatory authority over thrifts including authority to restrict activities of thrifts not meeting minimum capital standard requirements.

We note also, however, that the proposal would not do away with all tax and regulatory advantages thrifts have over commercial banks, including the important tax provisions thrifts have as specialized mortgage lenders. Those same tax provisions are not allowable to commercial banks, even though commercial banks have substantially increased their mortgage lending in recent years.

As noted earlier in our statement, the era of a specialized mortgage lender would appear to have come to on an end and it would make more sense to broaden that support to include all depository institutions rather than a specialized few. If public policy is to subsidize and provide special benefits to the housing market, they should be available to all lenders not just those which are forced by statute to be a specialized lender to that sector of the economy. It would be far better to have the subsidy or the tax benefit follow the financial instrument as opposed to following a specialized type of financial institution.

As we understand it, the proposal retains the so-called qualified thrift lender test, in which the thrift holding 60% of its assets in residential related lending qualify for both access to subsidized long term lending from the Federal Home Loan Banks and certain tax benefits. It would be far more equitable to extend those benefits to all institutions.

It should be noted also that thrifts will be given ten years to write off current goodwill that is counted as part of their capital. As a general rule, commercial banks are not allowed to count goodwill as capital. This goodwill, representing as it does the difference between market value and book value of an institution, represents a real economic value in our society that should not be ignored. This is not "regulatory" capital in the same sense as that authorized by the Federal Home Loan Bank Board, since it is a valuation of economic value made by the market. It would seem more appropriate to allow all institutions to continue to retain goodwill as part of their capital, rather than requiring them not to include it at all, as is the case with banks. Nonetheless, thrifts will have an advantage in being able to retain goodwill as part of capital during this ten year period while commercial banks are not accorded similar treatment.

As we understand it, thrifts not qualifying for the so-called qualified thrift lender test are intended to be treated in a regulatory sense the same as all banks, given an appropriate transition period. Under the administration proposal, thrifts would be permitted to move to the FDIC insurance fund five years after the date of enactment upon payment of an appropriate exit fee. ARCB would support such a plan if it included a requirement that all tax, accounting and regulatory treatments between banks and thrifts be the same.

We note that several major thrift institutions are seeking to shift to the FDIC insurance fund from the FSLIC fund now, as opposed to waiting until the five year period envisioned by the administration has expired. Without any change in the tax, regulatory and accounting treatment so that it is treated as a bank rather than a thrift, such a move would have to be opposed by ARCB. If the treatment for that thrift were the same as for commercial banks, ARCB would have no objection, with the exception of the business affiliations that thrift might have that banking organizations are not permitted.

Business Affiliations and Thrift Ownership

The business activities and regulatory burdens of banks and thrifts should be equalized. Bank holding companies should be allowed to acquire healthy thrifts.

One aspect of current thrift regulation which appears to be unaddressed in the administrations proposal is that of business affiliations for unitary thrift holding companies. Under current law, affiliations between financial and nonfinancial business entities are permitted under a unitary thrift holding company structure--that is a holding company which owns only one thrift institution. Indeed many of the recent troubled thrifts resolutions have involved selling thrifts to nonfinancial corporations as a means of injecting new capital into the thrift industry and resolving the insolvent thrift situation.

Such affiliations are not permissible under the Bank Holding Company Act. Thus, a major fundamental regulatory issue that will need to be addressed at some point is the question of business affiliations under two different legislative schemes. ARCB officially supports affiliations of a financial nature within the bank holding company structure. It has not formally adopted a position in support of affiliations of a nonfinancial nature under that structure, although many of its members would like to move in that direction. ARCB would have to address its position on that issue in the future should the business affiliations currently permitted unitary thrift holding companies, particularly those with federal assistance, be permitted in the future.

In the meantime, ARCB believes bank holding companies should be allowed to acquire any thrift. The acquisitions of thrifts by bank holding companies would allow new capital to be injected into the thrift industry from the banking system. The administration proposal would allow for such acquisitions beginning two years after the date of enactment. ARCB would encourage the adoption of such a provision to take effect immediately. Also, the restrictions on cross-marketing and other restrictions should be removed. As FDIC Chairman Seidman noted to the Committee:

> [T]he FDIC believes that bank holding companies should be permitted to acquire failed or failing S&Ls immediately, without the cross-marketing, activity and branching restrictions or any other restrictions that have been routinely imposed by the FRB [Federal Reserve Board]...The FDIC thinks that the imposition of cross-marketing, activity and branching limitations on the acquisition of failing and failed thrifts by bank holding companies unwisely curtails the ability of banks to buy thrifts and, thus, raises the insurers' costs.[23]

Furthermore, bank holding companies should be allowed to count the goodwill of thrifts they acquire as capital. This would make thrifts attractive acquisition targets for bank holding companies. If it would help, such goodwill could be written off over a period of years, perhaps forty years. Other approaches could be developed to make use of the goodwill of thrifts as part of the resolution of the thrift crisis by allowing bank holding companies to acquire them. What is important would be approaches designed to encourage bank holding companies to acquire thrifts and thus injection of new capital into the thrift industry at a time when it is vitally needed.

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[23] Testimony of L. William Seidman before the Committee on Banking, Housing and Urban Affairs, United States Senate, February 28, 1989, pp. 17-18.

Banking Deregulation

ARCB supports policies leading to more competitive opportunities in the financial service market place. Banking and the financial system should not be reregulated because of the thrift crisis. It was a lack of adequate supervision, not deregulation that created the thrift problem.

ARCB strongly supports the deregulation of the financial services sector. With specific reference to the banking industry, ARCB supports legislation, such as that adopted in the Senate last year, that would authorize banks to offer new products and services to their customers.

As noted earlier, it is widely recognized among regulators and others, that the problems of the thrift industry were caused in part because of inadequate supervision and examination. New competitive opportunities offered to the thrifts were not adequately supervised. As the Arnold & Porter and Secura Group Report note: "thrift institutions were encouraged to enter new areas of lending with which neither the institutions nor their federal regulators had any experience."[24] ARCB does not believe this experience should be used as an excuse not to move ahead in offering new products and services opportunities for commercial banking, where capitalization is higher and regulatory standards more strict than they are in the thrift industry.

The crisis should certainly not be used as an excuse to reregulate the financial service marketplace. It was regulation of the thrift industry in the form of restrictions on it as a specialized lending institution for housing that caused many of the problems the thrift industry faces today. One lesson that should be learned from the thrift crisis is that financial institutions need the flexibility to adjust to a new and changing financial marketplace if they are to remain vibrant and functional in the future.

It is widely recognized that the thrift supervisors were not prepared to handle their responsibilities toward the thrifts. The Chairman of the Federal Home Loan Bank Board, M. Danny Wall, when he testified before this Committee last May, for example, noted that:

> [T]he Board's supervisory function, both in terms of numbers and experience of staff as well as policies and procedures, was, quite frankly, inadequate. In some districts it was more inadequate than in others to deal with the challenge posed by weak or dishonest thrift managements struggling with poorly capitalized or even insolvent institutions.
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> The result was that a minority of thrifts took significant risks either through fraudulent underwriting or offering loans for large interest rates. This

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[24] Arnold & Porter and the Secura Group, Report, Association of Reserve City Bankers, April 1988,p. 29.

deficiency in our supervision of the industry has been recognized and is well on its way to being corrected.[25]

Other experts on this subject appearing before this Committee last May were in agreement with this assessment of the inadequacies of the examination and supervisory treatment of the thrift industry. Frederick D. Wolf, Director of the Accounting and Financial Management Division of the General Accounting Office, for example, noted to the Committee that the regulators "didn't have the people to do it or the expertise." Stanley Silverberg, Consultant with Golembe Associates, and former Research Director for the FDIC, told the Committee that "a very big chunk of the problem...would lay at the doorstep of the past two administrations of the [Federal Home Loan] Bank Board, where growth was strongly encouraged and capital standards were not enforced."[26]

The study for ARCB by Arnold & Porter and the Secura Group note that there may be historical rearons for inadequacies in the regulation and supervision of thrifts. Until ten years ago, the assets of thrifts were largely limited to home mortgages made at fixed rates. Those assets did not require a highly trained supervisory staff. In addition, the Bank Board may have been understaffed relative to the federal bank regulatory agencies.

According to Arnold & Porter/Secura Group Report, the number of Bank Board personnel involved in regulatory matters totaled 4,196 in early 1988. This compares to 14,561 at the three bank regulatory agencies (Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve System), or more than three times the regulatory staff of the Bank Board. This translated into roughly 7.4 bank regulatory persons per $1 million in domestic deposits at banks versus 4.5 Bank Board regulators per $1 million in domestic deposits at thrifts. For field supervisors, the number of regulatory personnel for the bank regulatory agencies outnumbered the thrift personnel by close to four-to-one. The Bank Board and the District Banks [of the Federal Home Loan Bank System] may have been "simply been unable to hire and train staff at a pace equal to [the] challenges."[27]

We would note for the Committee some of the major distinctions which have been identified between the regulation of banks and thrifts. We refer the Committee to the section of the Arnold & Porter and Secura Group Report attached as Appendix A to our statement for additional discussion of the following points:

- Federal bank regulators are charged with serving the broader federal purposes of maintaining economic stability and an efficient payment system as well as preventing excessive concentrations of economic power in individual banking organizations; federal thrift legislation was designed to advance the development of the nation's housing stock;
- Federal regulation of thrifts is consolidated under the supervisory authority of a single regulator; federal banking regulation is dispersed;
- Federal thrift regulation is generally recognized as having a close affiliation between the thrift industry and its federal regulators; representation of the banking industry's interests has been characterized by divided viewpoints and a lack of cohesion;
- A less obvious factor is the close affiliation between the thrift industry and its federal regulators is the importance of the Federal Home Loan Banks, which members thrifts own, in the regulation of thrifts; only member banks of the Federal Reserve System own stock in Federal Reserve Banks, and those Banks do not play a comparable role in the development and implementation of federal bank regulations toward banks to that of the Federal Home Loan Banks to member thrifts.

In addition, the banking industry is far better capitalized than the thrift industry, where much of the capitalization that does exist is in "regulatory" form. As Stanley Silverberg noted to this Committee last May:

> Direct investment powers opened up riskier opportunities to institutions searching for high return and willing to take risks, and many used the powers poorly. A major contribution to the problem, however, as a breakdown in supervision. Capital requirements that were insufficient to cushion traditional S&L risks were certainly not sufficient to cushion riskier activities. And examination and supervisory policies were not prepared to deal with riskier asset portfolios.
>
> The S&L experience in the past decade demonstrates the problems inherent to a system where market discipline is eliminated (through de facto 100 percent deposit insurance) and where no meaningful capital standards and operating constraints are applied.[28]

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[25] Hearings, Oversight of the Condition of the Financial Services Industry, Committee on Banking, Housing and Urban Affairs, United States Senate, May 26, 1988, p. 335.

[26] Ibid., pp. 212-13.

[27] Arnold & Porter and Secura Group, Report, p. 23.

[28] Stanley C. Silverberg, "The Problems of Savings and Loans and FSLIC," Golembe Report, Volume 1988-3, as contained in United States Senate, Committee on Banking, Housing and Urban Affairs, Hearings, Oversight on the Condition of the Financial Services Industry, May 1988, pp. 162 and 166.

Future of FSLIC

Thrifts that are not insolvent or do not qualify for FDIC insurance should continue to be insured by the FSLIC. Serious consideration should be given to administering the FSLIC fund with the FDIC, and chartering and regulatory functions should be separated from the insurance function.

The administration's proposal is in line with ARCB's position on these matters. ARCB believes that thrifts that are not insolvent or do not qualify for insurance coverage under the Bank Insurance Fund should continue to be insured under the Savings Association Insurance Fund.

Under the administration's proposal, as we understand it, three insurance funds would be placed under the FDIC's management. The first would be Resolution Trust Corporation Fund which would now be used to resolve the S&Ls that are now GAAP insolvent or become so in the future. Another would be the Bank Insurance Fund which would be managed as a separate insurance fund for deposits at banks, as currently is now the case under the FDIC insurance fund.

A third insurance fund would be a new Savings Association Insurance Fund. As we understand, this third Fund would funded out of a combination of thrift industry insurance premiums and taxpayer funds. It is also our understanding that this Savings Association Insurance Fund (SAIF) would be the insuring facility for heathy thrifts. The only difference we would have with the administration on this point would be that it should be the insuring agency for healthy thrifts that do not meet the same tax, regulatory, accounting and capital standards as banks.

Those healthy thrifts that can meet those standards should, in our opinion, be allowed to come under bank insurance coverage. That would leave the new savings association insurance fund as the insuring agency for thrifts which either are not insolvent (in which case they would come under the new resolution trust fund) or the thrifts that are not up to bank regulatory standards (if they did meet those standards, we believe they could be insured by the Bank Insurance Fund.)

We understand there have been discussions about whether or not all insured thrifts would be allowed to display a window sticker indicating insurance by the FDIC, since all institutions will now come under the FDIC regulatory umbrella. This is an issue best left to future legislation because it is so controversial. Under the position statement adopted by ARCB, of course, healthy thrifts coming into the new Bank Insurance Fund would be allowed to display a bank insurance sticker in their window.

We agree with the administration's steps to bring the FSLIC under the FDIC administratively and to separate the insurance function of the thrifts from the chartering function of the Federal Home Loan Bank Board. According to the Arnold & Porter and Secura Group Report: "it appears that the special characteristics of the federal regulation of the savings and loan industry helped contribute to the industry's financial difficulties and the serious deficiency in the FSLIC insurance fund."[29] That Report went on to note that:

> The Bank Board, influenced by its role as operating head of FSLIC, was reluctant to close insolvent institutions. In many instances as a result of the industries departure from GAAP accounting, the bank could not ascertain the true capital position of reporting institutions. Even when it was clear that an institution had little or negative net capital, however, the bank board often permitted the institution to continue operations in the hope that it would ultimately regain profitability.[30]

We commend the administration for proposing that credit unions be required to expense, rather than include as an asset on their books, the one percent of deposits they are required to maintain in the credit union insurance fund. Banks are not permitted to include their assessments premiums going to the FDIC as part of their assets. This blurs the social capital of the National Credit Union Share Insurance Fund with private institution assets, potentially discouraging the use of that Fund's balances when needed to deal with problem institutions.

ARCB is growing increasingly concerned about the role of credit unions as tax exempt depository institutions serving an ever-enlarging marketplace outside traditional "common-bond" constraints. Not only is this creating increasing inequities between credit unions and other depository institutions such as thrifts and banks, but many of the regulatory problems in the thrift industry are also in evidence at credit unions. The chartering and regulatory authority of federal credit unions is overseen by the same agency that insures credit unions. Capital standards are not up to those applying to banks, and the ability to raise new capital is severely limited by the mutual form of ownership, which leaves retained earnings as the only source of additional capital. This is the same as with most thrifts today.

Other Issues

ARCB stands prepared to work with the new administration and the Congress in addressing these matters.

ARCB notes that the proposed legislation by the administration includes provisions calling for a review of other matters associated with deposit insurance reform. ARCB believes it important to address many of these matters in that study rather than addressing them in legislation needed now and quickly to address the thrift industry crisis. Many of these matters are controversial and should be addressed separately. ARCB stands prepared to work with the Congress and the Administration in addressing those matters.

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[29] Arnold & Porter and the Secura Group, Report, Association of Reserve City Bankers, April 1988,p 32.

[30] Arnold & Porter and the Secura Group, Report, Association of Reserve City Bankers, April 1988.

On one final matter, we note that the legislation proposed by the administration contains a number of provisions designed to substantially punish civil and criminal vioiations of regulations and laws applicable to all financial institutions. While no one can doubt that sound regulation calls for adequate enforcement powers, we do not believe the case has been made for revision in a substantial way the enforcement authorities applicable to commercial banks. There is a danger in casting too wide a net over the financially fraudulent transactions in one industry to apply remedies to another industry without a showing that reform is necessary. We have not had the opportunity to study in detail all of the provisions of the bill, but we urge caution in applying its enforcement provisions--provisions which encourage employee whistle-blowing" and increase fines and penalties for a variety of infractions to $1 million a day--to the commercial banking industry.

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We appreciate very much this opportunity to present the views of the Association of Reserve City Bankers on the FSLIC/thrift industry crisis and the administration's plan for dealing with it.

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ANTHONY T. CLUFF
EXECUTIVE DIRECTOR

ASSOCIATION OF RESERVE CITY BANKERS

ARCB

March 23, 1989

The Honorable Bob Graham
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241 Senate Dirksen Office Building
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Dear Senator Graham:

At the hearing of the Senate Committee on Banking, Housing and Urban Affairs, March 9,1989, you asked that ARCB provide additional information on the following statement in ARCB's statement:

> "In view of all this, it is reasonable to question the appropriateness of seeking to achieve a ratio of balances in the insurance fund relative to insured deposits specifically as high as 1.25 percent." (p. 17)

Enclosed for your purposes is a response to your question, which elaborates on the points made in the statement of ARCB on March 9, 1989. I hope this is responsive to your question.

Sincerely,

Anthony T. Cluff

Anthony T. Cluff

Enclosure

cc: Members of the Senate Committee on Banking, Housing and Urban Affairs.

DEPOSIT INSURANCE ASSESSMENTS

One objective the administration has in dealing with the crisis facing the Federal Savings and Loan Insurance Corporation (FSLIC) and the thrift industry is to strengthen the deposit insurance system. The legislation to enact the administration's proposal, for example, states one of its purposes to be "to put the federal deposit insurance system on a sound financial basis for the future."[1]

To help in achieving this, the administration is proposing an increase in deposit insurance assessments for banks and thrifts. For banks, the new assessment rate schedule would be as follows:

- *The current assessment of 8.3 basis points (1/12 of 1 percent of deposits) would remain in place for 1989.*
- *The assessment rate would be raised to 12 basis points in 1990.*
- *The assessment rate would be raised to 15 basis points in 1991 and for the years beyond.*
- *The assessment rate can be lowered if the FDIC, as overseer of the insurance funds, finds that the ratio of the Bank Insurance Fund's (the current FDIC insurance Fund's) net worth to insured deposits (the so-called "reserve ratio"), exceeds 1.25 percent and that the ratio is not likely to decrease during the next five years.*
- *The assessment rate for banks could also be raised as high as 35 basis points if the Fund has experienced a net loss in any of the prior three years, or the Fund's reserve ratio is less than 1.20 percent or extraordinary circumstances raise a reasonable risk of serious future losses to the Fund.*

The proposed increase in insurance assessments for banks has been justified as necessary because balances in the FDIC fund have declined and the funds from the increased assessment would bring the bank insurance fund back up to historical levels. Treasury Secretary Brady told congress that "*[w]e propose increasing*

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[1] The Financial Institutions Reform, Recovery and Enforcement Act of 1989.

commercial bank premiums to bring the FDIC fund back in line with its historical reserve-to-deposit ratio to protect depositors and taxpayers."[2]

FDIC Chairman Seidman has also noted:

> *In our recently released study on deposit insurance, we concluded that FDIC deposit insurance premiums should be adjusted for the risk and costs incurred by the insurance fund. The FDIC spent $7 billion dollars last year, and our fund declined by about $4 billion, or over 20 percent. Our fund's reserves at year-end will be reduced to 83 cents per $100 of insured deposits, well below desired levels. Without regard to the S&L industry problems, the FDIC study recommended that bank premium rates be increased to reflect more accurately recent loss experience of the FDIC fund.*[3]

Thus, it is proposed that the bank insurance fund be increased from the estimated current ratio of .83 percent at year-end 1988 to 1.25 percent. At the end of 1987, the ratio was 1.10 percent, and the historical average for the FDIC Fund from its beginnings in 1934 to 1987 was 1.40 percent.

The Association of Reserve City Bankers (ARCB) supports the administration's proposal, with assurances from the administration that bank insurance assessments would not be diverted into the thrift insurance fund or to the thrift industry. ARCB, however, did indicate in its testimony to congress that it was reasonable to question the appropriateness of seeking to achieve a ratio of 1.25 percent between the bank insurance fund and insured deposits. It did so for the following reasons:

- *It is unclear whether the increased assessments are being sought to make the bank insurance fund financially sound or whether they are being sought for budgetary reasons.*
- *Historical averages may be misleading for current needs.*
- *A rise in the bank failure rate is not foreseen.*

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[2] Testimony of Nicholas Brady before the House Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, February 23, 1989.

[3] Testimony of L. William Seidman before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, Committee on Banking, Finance and Urban Affairs, United States House of Representatives, March 8, 1989.

- *Although the ratio of the FDIC Fund to insured deposits has been declining, the ratio of the fund to total deposits has been rising.*
- *In addition to the social capital which the FDIC Fund represents, recognition should also be given to private capital at banks.*
- *The deposit insurance system was never expected to be used in the event of an emergency.*

Purpose of Increased Assessments

Current budgetary practices of the federal government make it difficult to determine with any precision the reason for an increase in bank insurance assessments at this time. One reason, as the administration has said, would be to increase balances in the insurance funds and thereby put those funds on a financially sound basis. But, another reason could be to offset expenditures that will be used to fund the thrift crisis.

Assessment income is counted as federal revenue in the federal budget. Thus, the increased assessment income will help in offsetting expenditures elsewhere in the federal budget, including those needed to fund the administration's thrift rescue plan. If insurance fund assessment income were off-budget, it would be clear that the only rationale for seeking increased insurance assessments of banks would be to improve the financial condition of the insurance funds. As matters now stand, there is a mixed rationale for seeking to increase insurance assessments for banks, and it is not clear that the only reason is to put the bank insurance fund on solid footing. That may be one purpose, but it may not be the only one.

The point here is important because the amount of new assessment funding being sought from the banking industry between now and the mid-1990's is not inconsiderable. FDIC Chairman Seidman has said that the proposed increase in premium expenses for banks translates to about 2.1 percent and 3.8 percent of the pre-tax earnings of banks. This translates, according also to the Chairman, into premiums totaling about $700 million in 1989 and $800 million beginning in 1990.[4]

It is important to note that this is not a one-year increase in assessments, but rather a permanent increase in overall assessment levels. It represents, therefore, a permanent reduction in potential bank earnings, which will be temporized only if and when the desired reserve ratio for the fund is reached and the FDIC makes a determination that either the assessment level can be reduced or assessments rebated. Thus, the increased assessment should be seen for what it is: a permanent diversion of bank income streams into the FDIC fund. Even if there is a reduction in the assessment level or a rebate of assessments, assessments paid up to that point will permanently have disappeared from the income stream of banks in the future. It should be noted that FDIC Chairman Seidman sees future income of banks being affected by the increase in deposit insurance premiums now being considered under the administration proposal.[5]

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[4] Ibid.

Using Historical Averages

The administration's rationale for seeking an increase in bank insurance assessments is to bring the bank insurance fund back in line with historical levels. Given this as the policy objective, the question then is one of selecting an appropriate historical horizon to use. The selection of an appropriate time period is, of course, rather arbitrary and whatever is selected can be open to criticism. Selection of an appropriate historical average for determining an appropriate level for the insurance fund is, nevertheless, important and it needs to be done carefully since the amounts of money involved are considerable and the potential impact on the banking system could be significant.

In the case of the deposit insurance fund, a long time horizon will produce an historical average that may not be appropriate for current purposes. It could easily overstate the amount of new insurance assessment income that is needed. The reason for this is that the fund's reserve ratio has been higher in the past than it is now. Thus, the "historical average" of the ratio will be higher as more and more years in the past are used in the calculation of the average.

As shown in Chart 1, the ratio of the FDIC deposit insurance fund to insured deposits has been on a downward trend. The ratio ranged from a high 1.96 in the early 1940's to the current ratio of .83 percent estimated by the FDIC for year-end 1988. Obviously, if this trend were to continue, the FDIC Fund would become inadequate at some point in the future. As it is, balances in the Fund totaled roughly $14 billion at the end of 1988.

Looking at Chart 1, it is easy to understand how the administration could rationalize the increased insurance assessments on banks. But, the question is at what point does the fund become adequate and when does it become inadequate.

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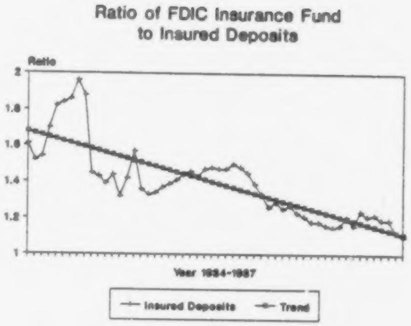
[5] FDIC, News Release, March 13, 1989.

CHART 1



Ratio of FDIC Insurance Fund to Insured Deposits

Most observers would conclude on the basis of Chart 1 that, if the fund is not now inadequate, it would become inadequate at some point in the future should present trends continue. But, at what level does this occur? Should the reserve ratio be 1.20 percent, for example, rather than 1.25 percent? What is there about 1.25 percent to commend it as a public policy objective?

Public policy in this area is being developed, at least in part, on the basis of historical averages. But, with the reserve ratio having changed over time, the historical average can vary widely depending on the years used in the calculation of that average. As noted earlier, the historical average for the reserve ratio using the entire period from 1934 to 1987 covered in Chart 1 is about 1.40 percent. This a relatively high historical average because it includes so many years in the early history of the fund when the size of the fund was relatively large for what was needed. It certainly is a higher average than the 1.25 percent now being sought by the administration. Public policy recognized it was high in the early history of the fund and, in view of the relatively low rate of bank failures during much of this period, rebates against on bank insurance assessments were approved then.

The administration has apparently used a shorter time frame than the entire history of the fund in its calculation of an appropriate historical average. It appears that the administration's average is one based on the fund's past 25 years. As shown in Table 1, the average for the reserve ratio for the 25 years of 1963 to 1987 was 1.25 percent. As also shown in Table 1, the average for the past five years is

1.18 percent. The average for the past 10 years is 1.18, the past 15 years 1.18 percent and the past 20 years 1.20 percent.

Obviously, the further back you go in history the higher the historical averages for the reserve ratio become. This, as noted earlier, is because the reserve ratio has been on a downward trend. So, the question becomes the number of years that would be appropriate to include in such a calculation. It's an important question because a different average is obtained when, say, the past five years are used than when the past 25 years are.

TABLE 1

Ratio of FDIC Fund to Insured Deposits

Year	Preceding 1 Year	Preceding 5 Years	Preceding 10 Years	Preceding 15 Years	Preceding 20 Years	Preceding 25 Years
1987	1.10	1.10	1.10	1.10	1.10	1.10
86		1.12	1.12	1.12	1.12	1.12
85		1.19	1.19	1.19	1.19	1.19
84		1.19	1.19	1.19	1.19	1.19
83		1.22	1.22	1.22	1.22	1.22
82			1.21	1.21	1.21	1.21
81			1.24	1.24	1.24	1.24
80			1.16	1.16	1.16	1.16
79			1.21	1.21	1.21	1.21
78			1.16	1.16	1.16	1.16
77				1.15	1.15	1.15
76				1.16	1.16	1.16
75				1.18	1.18	1.18
74				1.18	1.18	1.18
73				1.21	1.21	1.21
72					1.23	1.23
71					1.27	1.27
70					1.25	1.25
69					1.29	1.29
68					1.26	1.26
67						1.33
66						1.39
65						1.45
64						1.48
63						1.50
Avg.	1.10	1.16	1.18	1.18	1.20	1.25

But, five years is perhaps too short a time frame. The number of bank failures increased during this period, as shown in Chart 2, and this resulted in a drawdown on bank insurance fund balances. Prior to then, however, the number of bank failures and the amount of deposits held at those banks (see Chart 3) was relatively low. But, perhaps 20 years is not too short a time frame. Throughout most of the past 20 years, the number of bank failures was relatively low. The fund was more than adequate then. Using 20 years in the calculation of historical averages would result in a historical average of 1.20 percent rather than 1.25 percent.

The use of a 25-year historical average, therefore, may overstate current and future needs. So, too, may a 20-year average, for that matter. Obviously, the need is more a reflection of the prospective demand for the funds than a reflection of past averages. It is appropriate to question a particular historical average, therefore, not only because historical averages can vary widely, but also because they may be a poor guide to the future. Unless someone can forecast the failure rate for banks accurately, it is fair to question whether 1.20 percent isn't more appropriate than the 1.25 percent sought by the administration.

CHART 2

Number of Banks Closed
Because of Financial Difficulties

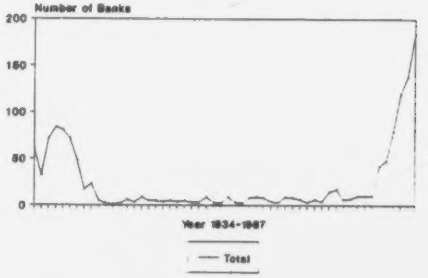
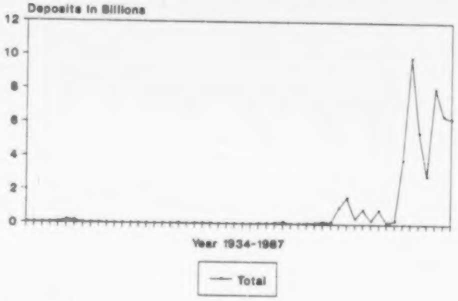


CHART 3

Deposits at Banks Closed
Because of Financial Difficulties



Projections of Bank Failures

Projections of the number of bank failures in the future is an uncertain science. But, it is worth noting anyway that expectations on this front are not overly pessimistic. FDIC Chairman Seidman, who supports the administration's plan to increase bank assessments, recently said himself that "[t]he good news is that we see fewer bank failures in 1989 and beyond."[6] A year ago, Chairman Seidman reported to the Senate Committee on Banking, Housing and Urban Affairs that the FDIC insurance fund was "strong and stable," and that, even if there were a decline in the fund, he said "we believe the FDIC fund is sufficient to deal with any problems we can foresee in the banking system."[7]

If it turns out to be correct that the fund is adequate and that there will be fewer bank failures in the future, the justification for increasing bank insurance assessments to replenish the fund up to 1.25 percent of insured deposits may be on somewhat insecure grounds. Throughout most of the fund's history, the level of the fund was adequate or more than adequate. That was because the number of bank failures and the amount of deposits involved was relatively small. Should that occur in the future, as Chairman Seidman suggests it might, then a reserve ratio of 1.25 percent for the fund may overestimate needs.

It should be noted that the number of banks on the "problem bank" list of the banking regulators has been on a downward trend since the second quarter of 1986. As a recent report of the FDIC noted:

> Most of the weakest banks have left the system. In addition, some "problem banks" have been converted to branches of other banks. But most significantly, many banks that found their way onto the "Problem Bank" list due to local economic problems and difficulty with the more competitive, deregulated environment of the 1980s, have succeeded in adapting, and have been able to shed "problem" status.[8]

Reserves Relative to Total Deposits

Another reason for raising questions about the appropriateness of increased deposit insurance assessments has to do with the size of the fund to total deposits. As shown in Chart 4, the ratio of the FDIC fund to total deposits, which includes total insured and non-insured deposits, has actually risen over the Fund's history. This upward trend is significant because, increasingly in recent years, actions by the FDIC have had the effect of extending FDIC insurance protection to all deposits, not just those that are insured. These practices have had unintended side effects and raised concerns about the need to reform the deposit insurance system to make certain that only insured deposits are afforded deposit insurance coverage.

Nonetheless, the practices have had the effect of extending the insurance coverage to all deposits. This raises the question of whether or not it might be more appropriate to focus on the reserve ratio that is calculated on the basis of total deposits, not just insured deposits. When viewed in this light, the upward trend in the reserve ratio shown in Chart 4 on the basis of total deposits would suggest that the FDIC fund has become better able to handle failed banks not less able to handle them and the Fund is better off today than in the past.

The point being made here is important enough to focus attention on why the reserve ratio of the Fund to *insured deposits* has declined. The ratio of the fund to

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[6] FDIC, News Release, March 13, 1989.

[7] FDIC, News Release, May 25, 1988; See also testimony of L. William Seidman, Hearings, Oversight on the Condition of the Financial Services Industry, Committee on Banking, Housing and Urban Affairs, United States Senate, May 25, 1988, pp. 24-25.

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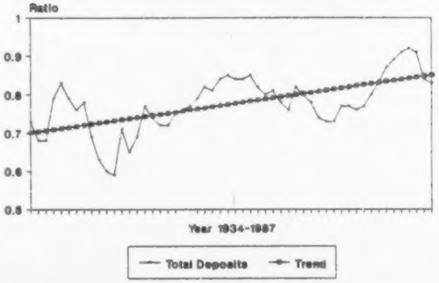
[8] FDIC, Quarterly Banking Profile, Fourth Quarter, 1988, p. 3.

CHART 4

Ratio of FDIC Insurance Fund
to Total Deposits



insured deposits has declined not because the balances in the Fund have been declining. Except for 1988, the FDIC Insurance Fund has increased every year since 1934. The decline in the ratio of the Fund to insured deposits (Chart 1) has, therefore, arisen because insured deposits have been increasing more rapidly than balances in the Fund.

An important reason behind the increase in insured deposits relative to the Fund has been the extension of deposit insurance protection to an expanding percentage of total bank deposits. As shown in Chart 5, the percentage of deposits that are insured has clearly been on an upward trend, increasing from 40 percent in 1934 to about 77 percent today. A correspondingly smaller percentage of deposits are uninsured today than in earlier years.

The upward trend in the percentage of deposits that is insured has occurred because insured deposits have increased as the deposit base has grown, but also because deposit insurance coverage has been expanded to include bigger deposits. In 1934, the limitation on insured deposits was $5,000. Today it is $100,000. The step-up in insurance coverage limitations between then and now is shown in Chart 6. The step-up in insurance coverage from $40,000 in 1979 to $100,000 in 1980 was particularly dramatic. In 1979, 65.9 percent of total deposits was insured. The following year, the total had risen to 71.6 percent. The increase had a significant effect on the reserve ratio. The reserve ratio (FDIC Fund to insured deposits) declined from 1.21 percent to 1.16 percent between those two years.

CHART 5

Percentage of Insured Deposits

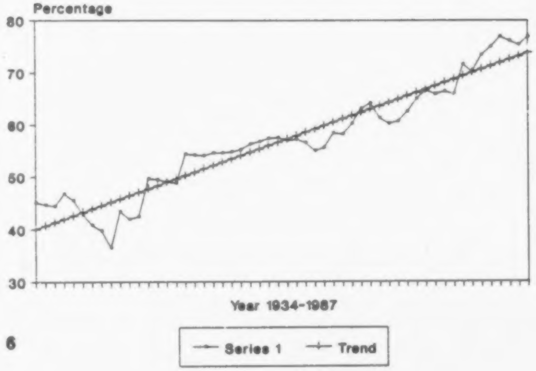
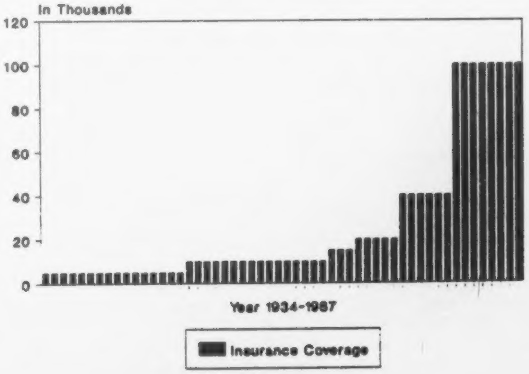


CHART 6

Insurance Coverage



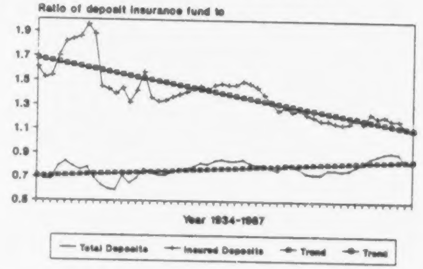
Had the percentage of deposits that is insured remained at about 66 percent, where it was in 1979, instead of increasing to 77 percent, where it is today, perhaps a different determination about the fund's adequacy would be underway. If only 66 percent of total deposits at banks in 1987 (1988 data are not yet available) were insured, which is the same percentage as in 1979, the ratio of the FDIC fund to insured deposits would have been 1.26 percent that year instead of 1.10 percent. The reserve ratio would have still fallen in 1988, because the fund itself declined. But, the decline would not have been as great as it was had the percentage of deposits that are insured not risen as it has over the life of the Fund.

To be sure, the percentage of deposits that is insured would likely have risen somewhat since 1979 even if deposit insurance coverage had not been increased to $100,000. The percentage has increased every year since then as insured deposits continued to grow more rapidly than non-insured deposits for a variety of other reasons. But the percentage would not have gone up as rapidly as it has. It's worth noting also that the higher coverage level of $100,000 may have been also one of those other reasons why insured deposits increased more rapidly than non-insured deposits. The brokering of deposits, for example, may have stimulated the growth of insured deposits relative to uninsured deposits.

In any case, it is fair to say that the reserve ratio--calculated as the ratio of the FDIC insurance Fund to insured deposits--has been on a downward trend because, for one reason, insured deposits have increased so substantially. The reserve ratio declined in 1988 also, of course, because the balance in the Fund declined for the first time in FDIC history. One reason why insured deposits have increased so rapidly as noted above, is that insurance coverage has been extended to larger and larger deposits. When the reserve ratio is calculated on the basis of the Fund relative to total deposits the trend is in the other direction. That is, the ratio of the Fund to all deposits has been on an upward trend since 1934. The trend for both ratios is shown in Chart 7.

In view of FDIC practices which result in coverage of all deposits at failed banks, it is appropriate to ask whether this might not be a better indicator of the fund's adequacy. If the interest is to cover all deposits, the Fund has held up pretty well on this score, as shown in Chart 4 and Chart 7 by the upward trend in the ratio of the Fund to total deposits. This, of course, does not address the appropriateness or inappropriateness of current FDIC practices in this area.

CHART 7



Insured Deposits and the
Deposit Insurance Fund

Private Capital

It is not unreasonable to question the appropriateness of a definite target of 1.25 percent for the reserve fund in light of what has occurred in the capital position of banks in recent years. Bank capital has increased substantially over the past several years. This improved capital position of banks provides a significant cushion within commercial banking to deal with unforseen contingencies. The $14 billion or so in social capital held as balances in the FDIC fund is in addition to the private capital held on the books of banks that can be used in the event of financial difficulties at banks should they occur in the future.

Equity capital at all insured commercial banks increased from $126.7 billion at the end of 1982, for example, to a reported $196.5 billion at the end of 1988.[9] This is an increase of almost $70 billion. The combined private equity capital of $196.5 billion on the books of banks and the $14 billion in social capital on the books of the FDIC is roughly estimated to be equal to 12.5 percent of insured deposits at year end 1988. This compares with 12.4 percent for the combined total at the end of 1982.

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[9] See Federal Deposit Insurance Corporation, Statistics on Banking, 1987, Table RC-9, p. 42 and Quarterly Banking Profile, Fourth Quarter 1988, p. 5.

As shown in Table 2, the ratio of aggregated *private* and *social* capital has held up quite well relative to insured deposits in recent years. In 1982, the ratio of combined *private* and *social* capital to insured deposits was 12.56 percent. Last year it is estimated to have been 12.48, even with a large decline in the social capital of the FDIC Fund. Indeed, throughout the period shown in the table, the ratio of combined private and social capital to insured deposits never fell below 12 percent. (The figures for 1989 are estimated from FDIC statements).

TABLE 2

Private and Social Capital Relative to Insured Deposits
(Amounts in Millions of Dollars)

	Private Capital Equity Capital of Insured Banks	Social Capital FDIC Insurance Fund	Total Private and Social Capital	Insured Deposits	Ratio of Private Capital to Insured Deposits	Ratio of Social Capital to Insured Deposits	Ratio of Total Capital to Insured Deposits
1982	$128,697	$13,771	$142,468	$1,134,221	11.35	1.21	12.56
1983	$140,459	$15,429	$155,888	$1,268,332	11.07	1.22	12.29
1984	$154,067	$16,529	$170,596	$1,389,874	11.08	1.19	12.27
1985	$169,200	$17,957	$187,157	$1,503,393	11.25	1.19	12.45
1986	$182,246	$18,253	$200,499	$1,634,302	11.15	1.12	12.27
1987	$181,369	$18,302	$199,671	$1,658,802	10.93	1.10	12.04
1988	$196,490p	$14,000e	$210,490	$1,687,000e	11.64	0.83	12.48

p = preliminary
e = estimated by FDIC or from FDIC statements
Figures may not total due to rounding

Source: FDIC, Banking Statistics, 1987 and Quarterly Banking Profile, Fourth Quarter 1988.

Expectations in an Emergency

The final point to be made in questioning the appropriateness of the 1.25 percent target of the administration's proposal has to do with expectations about the intent of the deposit insurance system and its ability to be used in the event of an emergency. To be sure, the intent of the deposit insurance system was to assure depositor confidence and provide stability to the banking system during periods of economic stress. But, the system was never designed to cover all situations. It was recognized that the there would be situations in which the deposit insurance system was inadequate and the federal government in general would become responsible for dealing with emergencies.

A report prepared by Peat Marwick Main & Co for the Association of Reserve City Bankers on the legislative history of the FDIC and the FSLIC clearly indicated that congress understood that, as important as the insurance funds may have been in supporting depositor confidence and handling failed institutions under most circumstances, balances in the insurance funds would not replace direct public funding in the event an emergency of substantial proportions were to arise.[10]

The point here is not that the insurance fund shouldn't be made adequate to the task it is asked to address. Rather, it is to question the task the deposit insurance system is being asked to perform. If the administration's proposal to seek a reserve ratio of 1.25 percent is to make the fund financially sound, that is a matter that deserves serious consideration and support. If, on the other hand, the proposal is but one of many steps that could be taken in the future to move the deposit insurance system more toward handling situations never intended for it, that is another. The underlying intent of deposit insurance would, it appears, have to be addressed if the latter were the case, because the legislative history to date suggests something else was intended.

This is not to suggest that achievement of a reserve ratio of 1.25 percent would mean that the deposit insurance system would then make it responsible for, or capable of, handling major emergencies. Clearly, it would not be capable of such a feat. Yet, there is a reasonable question about how far down this path the deposit insurance system should be taken. Already, the system has been expanded to include deposits it was never originally intended to cover, both by expanding the coverage of insurance on individual deposits up to $100,000 and pursuing policies that insured all deposits rather than those that are insured. The question is whether the movement to a fixed reserve ratio at 1.25 percent isn't a move to institutionalizing a broader role for deposit insurance than was ever intended.

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The administration's proposal intends to, among other things, put the deposit insurance system on solid footing. That is a goal which should be supported. The issue is not that, but rather the steps that are taken to achieve that goal. If the targeted ratio for the reserve ratio of the bank insurance fund of 1.25 percent accomplishes that objective, that is one matter. If that target is sought for budgetary purposes, it's another matter. So too would it be another matter if it is a target that overestimates the Fund's needs, fails to take into account current FDIC practices and capital condition of banks or moves the deposit insurance system further away from its original intent.

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[10] See Peat Marwick Main & Co, The Establishment and Maintenance of the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation as Separate Deposit Insurance Systems: A Legislative History, a paper prepared for the Association of Reserve City Bankers, January 16, 1989.

For that reason, the deposit insurance funds should be taken off budget so it is clear that the only reason for increasing assessments is to make the fund financially sound and not to increase the federal revenues. A better way of determining the need for assessments needs to be found than by calculating the need on the basis of historical averages. Actual need, rather than historical need, might be preferable. And, a review of the deposit insurance system is needed to assure that the system is serving the purpose for which it was intended.

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appointed and privately elected directors; and (3) restructure its ownership base using voting common stock that is publicly traded.

CONCLUDING REMARKS

NAHB views the Administration's legislative proposal as a valuable framework for comprehensive reform of the savings and loan system. In addition we have recommended a number of changes to this package. These changes are intended to preserve the strength of our financial system, to maintain the strength of both the primary and secondary housing finance systems, and to facilitate the management and disposition of insolvent thrift institutions and their real estate assets.

In closing, we would like to reiterate the perspective that lies behind our recommendations. We believe that the final legislation must strike a delicate balance. Clearly, Congress and the Administration must ensure that a situation similar to the current "thrift crisis" does not happen again. At the same time, you must seek the most cost-effective solution while keeping America's need for affordable housing clearly in focus.

In this regard, it is important that the solution maintains the value of the thrift charter and does not discourage the flow of private capital into the thrift industry. To do so would simply increase the cost to the taxpayer of dealing with the thrift crisis and increase the cost of residential mortgage credit for home buyers.

Finally, we would like to stress that specialization in housing finance has not been the source of the current "thrift problem." On the contrary, those institutions that have been heavily concentrated in mortgage loans and mortgage-backed securities have performed well. It is clearly possible to balance safety and soundness with a strong housing finance system.

APPENDIX A

to the
Statement of the Association of
Reserve City Bankers before
the Committee on Banking,
Housing and Urban Affairs
United States Senate
March 9, 1989

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Section II, Implications for the Banking
Industry of the Financial Condition of
the FSLIC and the Thrift Industry, by
Arnold & Porter and the Secura Group for
the Association of Reserve City Bankers,
April 1988.

II. Federal Regulation of Thrifts: Overview and Comparison with Banks

A. Brief History of Federal Thrift Regulation

The American savings and loan industry traces its origins to the cooperative savings societies and mutual savings banks of the nineteenth century. These early thrifts were local institutions established to provide a safe depository for personal savings and to promote home ownership by making residential mortgages, first exclusively for depositors at the institution and then later for the community at large. Without direct support or supervision by the federal government, the thrift industry grew rapidly in the late nineteenth and early twentieth century. By 1928, the industry included 12,666 institutions with more than $8 billion of assets.[1]

The thrift industry's independence from federal regulation came to an end in the 1930's. The severe economic dislocations of the Great Depression had a profound impact on residential mortgage lending. At the height of the crisis forty percent of the country's home mortgages were in default, and home foreclosures were proceeding at the rate of 26,000 per month. More than 1,700 thrifts ultimately failed, and for several years the economic viability of the entire industry was in doubt. A consensus soon developed for a federal solution to the plight of the home mortgage industry.

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[1] See A Guide to the Federal Home Loan Bank System 6 (5th ed. 1987). Much of the factual information in Part II is taken from this study, which was published by the Bank Board.

The result was the enactment of three major pieces of legislation in as many years: the Federal Home Loan Bank Act of 1932, the Home Owners' Loan Act of 1933, and the National Housing Act of 1934. Though substantially amended over the ensuing years, these three pieces of legislation created the regulatory structure for the federal regulation of thrifts that remains today. As we will also see, the policy underlying these original acts -- the promotion of home loans, home owners, and national housing -- also has had a profound impact on the development of federal regulation of savings and loan associations.

1. Federal Home Loan Bank Act

The first of these major pieces of federal legislation, the Federal Home Loan Bank Act, established a system of Federal Home Loan Banks ("District Banks")

to be supervised by the Federal Home Loan Bank Board.[2] The purpose of a Federal Home Loan Bank System was to provide liquidity and long-term funding to savings and loan associations and similar institutions with "sound and economical" home-financing policies.

Like the Federal Reserve System upon which it was modeled, the Federal Home Loan Bank System combines private ownership with governmental responsibilities. All of the capital stock of the District Banks must be owned by member institutions. However, the Bank Board, whose members are selected by the President with the advice and consent of the Senate, establishes the policies and operating procedures of the District Banks -- including the procedures for membership in the System.[3] In addition, the Bank Board participates in the selection of directors of the District Banks. As the result of subsequent legislation, the District Banks have also come to provide the organizational structure for many aspects of the federal regulation of thrifts.

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[2] 12 U.S.C. §§ 1421 - 1449 (1982 & Supp. IV 1986).

[3] 12 C.F.R. §§ 521--533 (1987).

In the fifty-six years since its establishment, the Federal Home Loan Bank System has successfully fulfilled its original mission -- providing additional funding for the savings and loan industry. As of December 31, 1986, the System had more than $108.6 billion in advances outstanding to member institutions.[4] These advances, which typically carry below-market interest rates, are partially funded by capital contributions and deposits from System members, but the bulk of the System's funding ($88.6 billion) comes from Federal Home Loan Bank bonds and discount notes sold in the public capital markets. The consolidated capital of the Home Loan Bank System as of December 31, 1986, was slightly in excess of $10.1 billion.

2. Home Owners' Loan Act

The Home Owners' Loan Act of 1933 ("HOLA") was the next major piece of federal legislation involving thrifts. At the time it was enacted, the most significant feature of the HOLA was the creation of the Home Owners' Loan Corporation ("HOLC"), a government entity administered by the Bank Board and funded by the Treasury. The HOLC's mandate was to purchase and

refinance delinquent mortgage loans -- largely from savings and loan associations and similar institutions. Between 1933 and 1936, the corporation fulfilled this role by acquiring $2.75 billion in mortgages -- an amount equal to more than ten percent of the nation's residential mortgage debt outstanding at the time. Although the HOLC ceased its lending activities in 1936 and was eventually liquidated in the early 1950's, the corporation has been credited with saving over 1.6 million families from foreclosure during the Great Depression.

The enduring legacy of the Home Owners' Loan Act has been the authority of the Bank Board to charter federal savings and loan associations and federal savings banks. This power was included in the act to permit the establishment of federally-chartered home lending institutions in communities that were not served by locally-chartered institutions. Over the years, the federal thrift has become the dominant charter in the savings and loan industry. At the end of 1985, slightly more than half of the 3,487 FSLIC-insured thrifts were federally chartered under the HOLA, and these federal thrifts controlled approximately 63.9 percent of the industry's deposits.

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[4] By way of comparison, deposits held by FSLIC-insured institutions equalled $890.7 billion at year-end 1986.

In its capacity as chartering authority of federal thrifts, the Bank Board has promulgated a comprehensive set of regulations establishing powers and corporate procedures for federal associations.[5] Given the important role of federal associations in today's thrift industry, the Bank Board's regulations are generally accepted as an industry standard, which is often emulated by state legislatures and regulators. In certain areas, such as interstate expansion, however, the Bank Board follows local thrift practices established by state law.

3. National Housing Act

The National Housing Act of 1934 was the third and most far-reaching piece of federal legislation enacted to revive the home mortgage business from the trauma of the Great Depression. The National Housing Act extended federal authority directly to the assets and liabilities of state-chartered thrift organizations. To begin with, the National Housing Act created the Federal Housing Administration ("FHA") whose role was to insure the repayment of mortgage loans. The theory behind this aspect of the legislation was that FHA-

qualified lenders, such as savings and loan associations, would be more likely to make home mortgages if these lenders were guaranteed repayment by an agency of the federal government.

Title IV of the National Housing Act brought a similar federal guarantee to the liability side of the thrift balance sheet by establishing the Federal Savings and Loan Insurance Corporation.[6] The FSLIC was designed to be, and remains today, a government-controlled corporation administered by the members of the Bank Board and charged with insuring deposits at federally chartered thrifts and state-chartered institutions engaged principally in home mortgage lending. By providing this insurance, the FSLIC was intended to assist in the attraction of funds to the savings and loan industry. In addition, the availability of FSLIC insurance served to put deposits at insured thrifts on a similar footing with those at FDIC-insured banks.

All federally chartered thrifts are required to obtain FSLIC insurance. In addition, most states now require state-chartered thrifts to maintain FSLIC insurance. To qualify as an FSLIC-insured institution, a thrift must become a member the Federal Home Loan Bank System and therefore acquire common stock in its District Bank. In addition, FSLIC-insured institutions are subject to a broad range of safety and soundness regulations promulgated by the FSLIC under Title IV of the NHA.[7] In practice, these FSLIC regulations establish an outer boundary for the activities of thrifts, whether chartered by the Bank Board or the states.

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[5] 12 C.F.R. §§ 534--556 (1987).

[6] Pub. L. No. 73-479, 48 Stat. 1246 (1934).

4. Other Significant Federal Legislation

Since the 1930's, Congress has periodically amended the three original statutes governing the federal regulation of the thrift industry. Most recently in the early 1980's, Congress passed the Depository Institutions Deregulation and Monetary Control Act[8] and the Garn-St Germain Depository Institutions Act,[9] which together expanded the powers of federally-chartered thrifts and also increased the authority of the FSLIC to assist or otherwise dispose of troubled institutions.

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[7] 12 C.F.R. §§ 561--574 (1987).

[8] Pub. L. No. 96-221, 94 Stat. 132 (1980).

[9] Pub. L. No. 97-320, 96 Stat. 1469 (1982).

In addition, in 1968 Congress passed the Savings and Loan Holding Company Act Amendments ("SLHCA").[10] This legislation extended FSLIC jurisdiction to companies and other organizations with control over FSLIC-insured institutions. As amended, the SLHCA restricts the operations of companies that control more than one thrift. The SLHCA imposes lesser restrictions on so-called "unitary" holding companies -- that is, companies controlling a single thrift subsidiary. The FSLIC has also supplemented the SLHCA's statutory requirements with a set of savings and loan holding company regulations.[11] The SLHCA is analogous in certain respects to the Bank Holding Company Act of 1956, as amended.

Also under the jurisdiction of the Bank Board is the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Since its establishment under the Emergency Home Finance Act of 1970,[12] Freddie Mac has securitized conventional residential mortgage for resale in the secondary markets. The savings and loan industry makes up the largest portion of Freddie Mac's clientele; other mortgage lenders, however, are also eligible to participate in various Freddie Mac programs.

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[10] Pub. L. No. 255, 82 Stat. 5 (1968) (codified as amended at 12 U.S.C. § 1730a).

[11] *See* 12 C.F.R. §§ 581--584 (1987).

[12] Pub. L. No. 91-351, 84 Stat. 451.

B. Comparing Federal Regulation of Thrifts and Banks

On paper at least, the regulatory frameworks for thrifts and banks are highly comparable. Both have a central banking system -- the Federal Reserve System for banks and the Federal Home Loan Bank System for thrifts. In both areas, the federal government has chartering authority: the Comptroller of the Currency is authorized to charter national banks under the National Banking Act, whereas the Bank Board can charter federal thrifts under the Home Owners' Loan Act. For both thrifts and banks, the federal government offers deposit insurance for state-chartered as well as federally licensed institutions.

As an outgrowth of its role as deposit insurer, the federal government also has developed a comprehensive system of regulations designed to promote safety and soundness in both industries. For thrifts as well as banks, federal regulation extends to applications for federal insurance, changes in corporate control, transactions with affiliates, and numerous

operational details. Supervision is maintained, in the first instance, by mandatory financial reporting and is supplemented by periodic on-site examinations. Federal authorities have extensive enforcement authority over both banks and thrifts, including the power to impose judicially enforceable cease-and-desist orders and to remove officers and directors for cause. Finally, in both industries, the federal government has the authority to close insolvent institutions and wide discretion in disposing of the institutions' assets and liabilities.

There are, in addition, a number of areas in which both industries are subject to the same regulations. For instance, as a result of the 1980 Monetary Control Act, the same reserve requirements apply to thrifts as well as banks. Moreover, certain consumer legislation -- notably the Truth-in-Lending Act and the Community Reinvestment Act -- applies both to savings and loan associations and banks. Other areas of parallel regulation include margin lending and (at least from August 10, 1987 to March 1, 1988) sections 20 and 32 of the Glass-Steagall Act, which prohibit affiliations of banks (and thrifts) with entities principally engaged in the securities business.

1. Difference in Congressional Mandate

Despite these formal similarities, there are also profound differences in the federal regulation of thrifts and banks. Perhaps most fundamental is the different federal policy underlying regulation in the two areas. The basic legislation establishing the federal regulation of banks emerged in response to a variety of general economic concerns arising since the mid-nineteenth century. The creation of a network of national banks in 1863 and 1864 was meant to establish a system of federal instrumentalities capable of funding the federal debt created by the Civil War. Later it was the goal of preventing the economic dislocations associated with bank failures that led to the enactment of the Federal Reserve Act in 1913 and the creation of the Federal Deposit Insurance Corporation in 1933. Finally, the enactment of the Bank Holding Company Act of 1956 was largely a response to the perceived threat to the national economy posed by the affiliation of large conglomerates and banks.

In contrast, the impetus for federal regulation of the savings and loan industry has always been the promotion of home ownership. All of the federal thrift legislation enacted in the 1930's had the express

function of ensuring the availability of home mortgages. Unlike the basic federal banking statutes, federal thrift legislation was not designed to advance any federal policy more general than the development of the national housing stock. Federal bank regulators, in contrast, are charged with serving the broader federal purposes of maintaining economic stability and an efficient payment system as well as preventing excessive concentrations of economic power in individual banking organizations.

2. Unified Regulatory Structure

Perhaps because of Congress's singleness of purpose in developing federal thrift regulation, another distinguishing characteristic of the federal regulation of thrifts is the consolidation of supervisory authority into a single agency. Either directly or in its capacity as operating head of the FSLIC, the Bank Board performs regulatory functions equivalent to the Comptroller of the Currency's chartering of national banks, the FDIC's insurance of commercial banking depositors, and the Federal Reserve Board's dual tasks of supervising bank holding companies and administering the Federal Reserve System. Even though federal regulation of thrifts has evolved through a number of federal statutes, near exclusive federal jurisdiction over thrifts has been vested in the Bank Board.[13]

This unified regulatory structure permits federal thrift regulation to act with greater coordination than the balkanized banking agencies. As will be seen, unified regulation can also foster undesirable side-effects when all of the regulatory functions of the thrift agencies are forced to serve the needs of home ownership.

3. Affiliation Between the Industries and Their Regulators

Another distinguishing characteristic of federal thrift regulation is what has generally been recognized as a closer affiliation between the thrift industry and its federal regulators than exists in the area of banking. There are a number of institutional reasons why this closer affiliation may have developed. One factor is undoubtedly the presence of strong and effective lobbying organizations. This lobbying effort has been very successful over the years in obtaining favorable legislation -- from tax breaks to expanded

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[13] In a few areas, notably reserve requirements and margin lending, the Federal Reserve Board also exerts jurisdiction over thrifts

powers -- for the thrift industry. More importantly, the President has generally appointed to the Bank Board only individuals affiliated with the thrift industry or at least generally acceptable to its representatives.

In contrast, representation of the banking industry's interests in Washington has been characterized by divided viewpoints and a lack of cohesion. Moreover, appointments to senior bank regulatory positions have historically been made with less concern for industry approbation, and more agency career employees have succeeded to the top staff jobs at the banking agencies than at the Bank Board.

4. Federal Home Loan Bank System

Another less obvious factor contributing to the close affiliation between the thrift industry and its federal regulators is the importance of the Federal Home Loan Banks in the regulation of thrifts. As mentioned earlier, the District Banks are owned by member institutions, and a majority of their directors are elected by the membership. The thrift industry therefore has considerable control over the activities and policies of the District Banks. The District Banks, in turn, are responsible for much of the supervision of the thrift industry. The supervisory personnel responsible for examining and regulating thrifts on behalf of the Bank Board are primarily located at the District Banks, and (as the result of a 1985 reorganization) are now actually employees of the District Banks. In addition, the president of each District Bank is designated the principal supervisory agent for member institutions of the District Bank, and has considerable discretion in dealing with member institutions on a wide variety of regulatory issues. Through their on-going dealings with the Bank Board, the District Banks communicate the interest of their members to the Bank Board, and thereby promote the close relationship between the thrift industry and its federal regulator.

The federal structure of bank regulation has no precise analog to the Federal Home Loan Bank System. While the Federal Reserve System is built around a similar system of privately-owned Federal Reserve Banks, the Federal Reserve Banks do not play such an important role in developing and implementing federal bank regulations. (Indeed the Federal Reserve Banks have no direct jurisdiction over national or state non-member banks.) Moreover, the Federal Reserve Board of Governors in Washington is much more independent from the banking industry and the Federal Reserve Banks than the Bank Board. Of course, the other two federal bank agencies -- the Comptroller of the Currency and the FDIC -- maintain their own network of offices around the country and have no formal affiliation with the Federal Reserve Banks.

5. Differences in Personnel and Expertise

Whatever the similarities in formal structure of bank and thrift regulation, there are clearly also pronounced differences in the regulatory personnel employed in the two systems -- both in terms of quality and quantity. For a variety of reasons, all three of the federal banking agencies have been able to attract and retain a large number of competent career employees. This pool of qualified personnel has greatly assisted the banking agencies in regulating their industry effectively and efficiently. The expertise of their personnel has also permitted the bank agencies to respond to industry developments with a fair degree of speed and flexibility.

The Bank Board, in contrast, has not developed as stable and highly qualified a cadre of supervisory personnel, although within the last two or three years the strength of the Bank Board's senior staff has been greatly enhanced. Partially, the reason for this difference is historical. In the past, when the thrift industry was largely limited to fixed interest home mortgages, regulation of savings and loan associations was fairly simple and did not require a highly trained supervisory staff. In the past ten years, however, the powers of savings and loan associations have expanded dramatically, in many areas now rivaling or even exceeding the powers of commercial banks. Moreover, loan quality problems have replaced interest rate mismatch problems as the principal issue confronting supervisory and liquidation personnel. Asset quality problems are more demanding of supervisory personnel, and also require a higher level of training. The Bank Board and the District Banks have simply been unable to hire and train staff at a pace equal to these challenges. No doubt the quality of personnel at the Bank Board has also been adversely affected by the high turnover of senior officials at the agency and the public perception that the agency has failed in its regulatory mission.

Wholly aside from issues of quality, however, the Bank Board is seriously understaffed when compared to the federal banking agencies. As of early 1988, the

Bank Board's total staff in Washington included -,020 full-time employees. In addition, the twelve District Banks employed 6,298 individuals, of which 3,176 were involved in regulatory affairs (including failure resolution activities) and the balance were assigned to the lending and capital raising functions of the District Banks. Accordingly, the total number of Bank Board personnel involved in regulatory matters is roughly 4,196.

In comparison, the federal banking agencies reported the following staffing levels:

Agency	Washington	Field	Total
FDIC	1,102	7,715	8,817
OCC	700	2,600	3,300
Federal Reserve[14]	263	2,181	2,444
Total	2,065	12,496	14,561

The banking agencies have more than three times the regulatory staff of the Bank Board. In the critical area of field supervision, regulatory personnel for banks outnumbers thrift personnel by close to four-to-one.

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[14] Federal Reserve Board employees are limited to those assigned to the Bank Supervision and Regulation Division.

Whether these disparities in staffing are appropriate is a difficult question. On the one hand, because FSLIC-insured thrifts now number roughly a quarter of FDIC-insured banks, the current ratio of thrift to banking staff might seem reasonable. If measured by the size of their respective industries, on the other hand, a different conclusion would be drawn. In 1987, the domestic deposits of banks were approximately $1.96 billion or only slightly more than two times total thrift deposits ($0.93 billion).[15]. This ratio suggests the banking agencies are better staffed in comparison to the Bank Board. Certainly if one were to compare the supervisory tasks confronting the thrift and banking industries, one would readily conclude that the federal thrift agencies were extremely understaffed compared to their banking counterparts. Later in this study, we will return to the issue of comparative staffing after we have considered the number of troubled institutions under the jurisdictions of the federal thrift and banking agencies and the expected costs of resolving their respective problems.

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[15] FDIC-insured banks also had about $337 million in deposits at foreign branches.

C. Federal Thrift Regulation and the Current FSLIC Crisis

Undoubtedly many factors contributed to the current financial problems facing the savings and loan industry and the FSLIC insurance fund. At the beginning of this decade, the industry was seriously weakened by the effect of rising inflation on balance sheets composed of long-term assets and short-term liabilities. Before these difficulties were fully resolved, the industry -- particularly that portion located in the southwestern region of the country -- was undermined by an unprecedented decline in world oil and agricultural prices, which depressed local economic conditions and real estate markets. At the same time, the industry faced new and sophisticated challenges from mortgage bankers and other financial intermediaries who have been making significant inroads into the residential lending market throughout the past decade.

Arguably under such extreme circumstances, there may have been nothing that federal thrift regulators could have done to prevent the current crisis in the thrift industry. There is, however, reason to believe that the peculiar characteristics of federal thrift regulation and the resulting response of federal thrift regulators to the interest-rate problems of the late

1970's and early 1980's may have exacerbated the industry's current difficulties.

It is undoubtedly the case that the Bank Board responded to the industry's interest rate problems differently from the way the federal banking agencies dealt with analogous problems involving FDIC-insured mutual savings banks during the late 1970's and early 1980's. Compared to the Bank Board, the FDIC took a consistently more strict position with respect to troubled savings banks. Many weak savings banks were merged into stronger institutions with FDIC cash (or cash equivalent) assistance; those that could neither raise new capital nor merge into stronger institutions were not permitted to grow or engage in risky activities.

During the same period and faced with a similar albeit much more extensive problem, the Bank Board took a more lenient approach. In order to ensure the preservation of a specialized home-lending industry, the Bank Board went to extraordinary lengths to revive troubled savings and loan associations. In a variety of areas, the Bank Board waived generally accepted accounting principles and permitted troubled institutions to issue financial statements based on

regulatory accounting principles ("RAP"), which tended to overstate income and capital.[16] At the same time, the Bank Board, with the concurrence of Congress, lowered its capital requirements for FSLIC-insured institutions, and then adopted a policy of capital forbearance for institutions under its jurisdiction.[17] Finally, the Bank Board promoted the expansion of thrift powers so that troubled institutions could acquire new, high-yielding assets to offset lower earnings generated by home mortgages, but was unable to take effective action to prevent high-flying institutions from funding growth with expensive out-of-state deposits and brokered funds.[18]

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[16] For example, during this period, RAP accounting was adopted to allow the amortization of loan losses, to permit the booking of appraised equity capital, and to permit favorable accounting treatment of certain securities and options transactions.

[17] Capital forebearance during this period took a number of forms. For some institutions, the Bank Board created paper capital entries under its ICC and net worth certificate programs. All institutions profited from the Bank Board's five-year averaging and twenty-year phase-in rules, which allowed FSLIC-insured institutions to grow first and then supply capital later.

[18] The Bank Board did, however, join the FDIC in litigation to restrict the use of brokered deposits. The agencies' position was eventually rejected by the District of Columbia Court of Appeals.

At the same time, the Bank Board, influenced by its role as operating head of FSLIC, was reluctant to close insolvent institutions. In many instances, as a result of the industry's departure from GAAP accounting, the Bank Board could not ascertain the true capital position of reporting institutions. Even when it was clear that an institution had little or negative net capital, however, the Bank Board often permitted the institution to continue operations in the hope that it would ultimately regain profitability.

In retrospect, it is easy to criticize the Bank Board's accommodative approach to the savings and loan crisis of the late 1970's and early 1980's.[19] In large part the agency's actions were dictated by the fact that the FSLIC lacked the financial resources necessary to take more effective enforcement actions. Nevertheless, as a result of the Bank Board's policies, thrift institutions were encouraged to enter new areas of lending with which neither the institutions nor their

federal regulators had any experience. Due to the Bank Board's lack of trained supervisory personnel, several years often elapsed between examinations of FSLIC-insured institutions. Many institutions that were marginally insolvent during the early 1980's were permitted to grow to be major supervisory problems by the end of the decade. It is now clear that the Bank Board's policy of forbearance and deviation from generally accepted accounting principles had significant costs -- both to the FSLIC insurance fund and also to the integrity of federal regulatory system.

For purposes of the present study, however, the more important point to be made about the Bank Board's policy choices in the late 1970's and early 1980's is how they reflected the peculiar characteristics of the savings and loan industry. During the years of interest-rate crisis, the Bank Board was under severe pressure from the thrift industry to refrain from any radical regulatory responses. The traditionally close affiliation between federal regulators, the Federal Home Loan Banks, and the industry at large made this pressure almost irresistible -- particularly in view of the fact that the Bank Board's budget, unlike the three federal banking agencies, is subject to the congressional appropriations process. Regulatory efforts at the state level in many jurisdictions were similarly constrained.

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[19] Indeed the Bank Board has long since recognized the unfortunate consequences of its policies, and has taken a number of steps in the last three years to reverse its previous positions. For instance, the Bank Board has adopted regulations returning the industry to GAAP accounting, has adopted measures to restore meaningful capital requirements for the thrift industry, and has also taken a number of steps to restrict high-risk activities by insured institutions.

In addition, throughout this period the Bank Board interpreted its congressional mandate to promote home mortgage lending as a directive to preserve the savings and loan industry at all costs. It appears that the Bank Board allowed its concern for the preservation of the home lending industry to override other policy considerations -- notably the need to preserve the integrity of the FSLIC insurance fund. Many of the Bank Board's policies countenanced, if not actually encouraged, unsafe and unsound practices at FSLIC--insured institutions.

The Bank Board's lack of human and financial resources also undoubtedly contributed to the rapid deterioration in the savings and loan industry. The system simply lacked the personnel necessary to provide effective supervision to the thrift industry, particularly as it expanded into new lending and investment areas. Also, the Bank Board had neither the personnel nor the financial resources necessary to close all of the troubled institutions on its docket in the early 1980's, even if it had been inclined to do so.

In conclusion, it appears that the special characteristics of the federal regulation of the savings and loan industry helped contribute to the industry's financial difficulties and the serious deficiency in the FSLIC insurance fund. Any legislative proposal to recapitalize the FSLIC insurance fund should therefore consider the question of whether a basic restructuring of the federal regulation of thrifts is also in order.

APPENDIX B

to the
Statement of the Association of
Reserve City Bankers before
the Committee on Banking,
Housing and Urban Affairs
United States Senate
March 9, 1989

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Legislative History of the FDIC and FSLIC,
prepared by Peat Marwick Main & Co. for the
Association of Reserve City Bankers
January 16, 1989.

KPMG Peat Marwick

THE ESTABLISHMENT AND MAINTENANCE OF THE FEDERAL DEPOSIT INSURANCE CORPORATION AND THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION AS SEPARATE DEPOSIT INSURANCE SYSTEMS: A LEGISLATIVE HISTORY

Prepared For The Association of Reserve City Bankers

By

KPMG Peat Marwick

Financial Institutions Regulatory, Legislative, and Policy Consulting Group

January 16, 1989

EXECUTIVE SUMMARY

Congress passed several laws between 1933 and 1950 to establish and make refinements in the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC). The legislative history of these laws was examined to determine answers to the following questions:

- Did Congress between 1932 (when House Committee on Banking and Currency held extensive hearings on bank deposit insurance) and 1950 contemplate a possible future merger or sharing of financial resources between the FDIC and FSLIC? If so, under what circumstances?
- Did Congress between 1932 and 1950 consider any proposals to prohibit or otherwise limit a merger or other financial arrangement between the two federal deposit insurance funds?
- Did Congress between 1932 and 1950 discuss the possibility of an eventual homogenization of the commercial banking and thrift industries?

The legislative history of the following laws* was examined in this effort:

- Banking Act of 1933 (Created temporary FDIC)
- National Housing Act of 1934 (Created FSLIC)
- Banking Act of 1935 (Established permanent FDIC)
- Federal Deposit Insurance Corporation Amendments, 1947 (Provided for retirement of FDIC capital stock and establishment of $3 billion line of credit from Treasury)
- Federal Deposit Insurance Act of 1950 (Provided for increased FDIC insurance coverage and the establishment of premium "rebate" system)
- Amendments to Federal Home Loan Bank Act and National Housing Act, 1950 (Provided for increased FSLIC insurance coverage and the establishment of $750 million line of credit from Treasury)

* The legislative history of laws enacted between 1933 and 1950 was reviewed because this period encompasses the formative years in the development of the FDIC and FSLIC -- from their establishment in the 1930's to the first comprehensive review and modification of the FDIC in 1950.

The examination produced several major findings:

- Between 1932 and 1950, Congress did not contemplate a possible merger of the FDIC and FSLIC. Neither a merger nor any kind of financial arrangement between the two funds was discussed in Congressional hearings, floor debate, or reports.
- Between 1932 and 1950, Congress did not consider an explicit prohibition or other restriction on either a merger of the two deposit insurance funds or a financial arrangement between the funds.
- Between 1932 and 1950, Congress did not contemplate or raise the possibility of an homogenization of the commercial banking and thrift industries.

Certain inferences can be drawn from Congressional debate and actions between 1932 and 1950 pertaining to the FDIC and FSLIC, which explain the absence of any discussion of a merger or financial arrangement between these two federal deposit insurance funds.

- The commercial banking and traditional thrift (i.e., savings and loan-type institutions) industries were perceived by the Congress as separate and distinct, with substantially different functions and modes of operation, which led to the establishment of two totally separate deposit insurance systems.
- Through 1950, Congress considered the existence of separate and distinct commercial banking and thrift industries to be desirable, as each industry played a special role in the American society and economy. Further, the mutual savings bank industry was viewed as different from both the commercial banking and the savings and loan industries and therefore accorded separate treatment.
- Congress clearly designed the FDIC and FSLIC to be mutual and self-funding deposit insurance systems.
- Legislation passed by Congress between 1933 and 1950 to provide the FDIC and FSLIC with sources of emergency funding reflects the Congressional view that the two federal deposit insurance systems were totally separate entities. Congress provided that if an emergency situation required additional financial resources, the FDIC and FSLIC could obtain them from additional premium assessments; the private capital markets; and/or Treasury borrowings. Congress did not consider the proposition that in an emergency, one fund should

be permitted to borrow or otherwise tap the resources of the other. Moreover, the possibility of a merger between the FDIC and FSLIC was never mentioned in Congressional discussions of how the deposit insurance funds might handle an emergency.

- While Congress between 1933 and 1950 provided the FDIC and FSLIC with sources of contingency funding, it generally expected the two deposit insurance systems to have sufficient reserves to withstand all but the most dire of economic crises. If the FDIC and FSLIC did experience difficulties during a full-scale depression, Congress believed that federal government assistance would be required. Congress never even considered the option of merging the two deposit insurance systems or combining their resources during such a crisis. On the other hand, Congress never considered placing any restrictions on a merger or other type of financial arrangement between the FDIC and FSLIC during a depression.

- The legislative history provides no evidence that Congress ever intended for FDIC reserves to be used for purposes other than the insurance of FDIC members' deposits. To the contrary, some Congressmen serving in 1950 recognized the possibility of future federal government "raids" on the FDIC fund and advised their colleagues to vigilantly guard against such threats to the fund. For example, during debate on the Federal Deposit Insurance Act of 1950, Congressman Paul Brown of Georgia, a senior Democrat on the House Banking Committee, warned:

  > ..."its [FDIC insurance fund] safety or guardianship is a sacred trust. We must always be aware of any attempt to raid this fund either directly or indirectly, such as attempting to alter in any way the independent status of the FDIC."

The legislative history reveals that in the 1930's, Congress was not averse to the idea of including in the FDIC depository institutions other than commercial banks. A precedent for this approach was established in 1933, when mutual savings banks were permitted to become members of the FDIC. The uniqueness of the mutual savings bank during the early years of the FDIC was reflected in the Banking Act of 1935, which provided that the Corporation's Board, at its own discretion, could establish a segregated fund within the FDIC for the mutual savings banks. However, this authority was never exercised, and in 1950, with the blessing of the savings bank industry, it was deleted from the law.

PREFACE

In late 1988, the Association of Reserve City Bankers approached KPMG Peat Marwick's Financial Institutions Regulatory, Legislative, and Policy Consulting Group to request assistance with a study of the establishment and maintenance of the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) as separate deposit insurance systems. Peat Marwick subsequently agreed to undertake the project.

Specifically, Peat Marwick agreed to research the legislative history of relevant laws enacted between 1933 and 1950, a period that represents the formative years in the development of the FDIC and FSLIC. The objective of this research was to find answers to several questions regarding the historical separation of the FDIC and FSLIC:

1) Does the legislative history of the laws establishing the FDIC and FSLIC contain any discussion of a prohibition or other restriction on the merger of the two federal deposit insurance funds?

2) Does this legislative history contemplate a possible future merger of the two funds? If so, under what circumstances?

3) Does this legislative history include any discussion of an eventual homogenization of the banking and thrift industries?

Peat Marwick also agreed to write a report on the findings of its research.

Jayne Boelman, senior consultant with the Financial Institutions Regulatory, Legislative, and Policy Consulting Group, participated in the project under the direction of Steven M. Roberts, a principal in the firm.

I. INTRODUCTION AND SUMMARY

In 1933, Congress passed the Banking Act of 1933, which created a temporary Federal Deposit Insurance Corporation and laid the foundation for the eventual establishment of a permanent fund. Membership in this deposit insurance system was open to commercial banks and mutual savings banks. In 1934, Congress extended the temporary FDIC and in the following year, passed the Banking Act of 1935, which made the FDIC a permanent insurance system.

In 1934, Congress passed the National Housing Act, which established the Federal Savings and Loan Insurance Corporation. This fund, parallel in many ways to the FDIC, provided deposit insurance to thrift institutions, including federal savings and loan associations, building and loan associations (precursors of today's savings and loan associations), homestead associations, and cooperative banks.

In the fifteen or so years following the establishment of these federal deposit insurance systems, legislation was enacted to amend the laws that created them. The most significant of these were amendments to the Federal Deposit Insurance Corporation passed in 1947; the Federal Deposit Insurance Act of 1950; and amendments to the National Housing Act passed in 1950.

During this entire period, between 1932 (when the House Banking Committee held extensive hearings on bank deposit insurance) and 1950, Congress engaged in active debate on many issues fundamental to the organization and operation of the FDIC and FSLIC. These issues ranged from eligibility requirements for participation in the deposit insurance systems, to the establishment of an appropriate premium structure, to suitable sources of contingency funding. However, the notion of a possible merger of the FDIC and the FSLIC never was raised in Congressional discussions or debates during this period. Nor did anyone ever propose that a financial mechanism be authorized through which the FDIC and FSLIC might borrow or receive grants from the other in an emergency situation. Moreover, Congress never considered placing any kind of specific restrictions on the relationship between these two federal deposit insurance corporations, whether it be a merger or an inter-agency financial relationship.

Since the merger and inter-agency financial arrangement issues were not raised in Congress between 1932 and 1950, it is impossible to state with certainty what the collective position of Congress or the individual views of Congressmen might have been toward these ideas. However, certain inferences can be made from the legislative history of relevant laws enacted during this period, which may explain why these issues were never raised and why Congress might have opposed them had they been raised.

FACTORS EXPLAINING ABSENCE OF CONGRESSIONAL INTEREST IN A MERGER BETWEEN THE FDIC AND FSLIC

Specifically, several factors can be inferred from Congressional deliberations on the establishment and modification of the FDIC and FSLIC which help explain the absence of any mention of a merger or other financial relationship between the two funds.

Perhaps most significantly, in the 1930's and up through 1950, commercial banking and the more traditional segment of the thrift industry (composed largely of building and loan associations, now known as savings and loan associations) were considered by Congress to be two separate, distinct industries, each with its own special role to play in American society. (The mutual savings bank, the other segment of the thrift industry, differed significantly from the S&L in structure and operation until quite recently and as a result, was accorded somewhat different treatment by Congress.)

Between 1933 and 1950, the distinction between these two industries was viewed as a positive characteristic of the U.S. financial system. There was no discussion in Congress about either the inevitability or the desirability of an homogenization of the commercial banking and traditional thrift industries.

In addition, in 1933, shortly before the establishment of FSLIC, Congress had created the Federal Home Loan Bank System to promote home mortgage lending, the basic business of the savings and loan segment of the thrift industry. When Congress created FSLIC, primarily for the purpose of promoting savings in savings and loan-type institutions so that more funds would be available for mortgage lending, it chose to place this new agency under the aegis of the Federal Home Loan Bank Board. The FSLIC fit neatly into this System, since both shared the fundamental objective of promoting mortgage lending.

As a result of factors such as these, Congress deemed it appropriate to establish two completely separate, though parallel, deposit insurance systems for the commercial banks (with mutual savings banks included) and the savings and loan segment of the thrift industry.

Moreover, the legislative history of the FDIC and the FSLIC indicates a clear Congressional intent to establish and maintain them as two separate deposit insurance systems.

When the FSLIC was established in 1934, in the year following the creation of the FDIC, no one even proposed (in Congress, at least) that a separate fund for the traditional thrifts be created under the aegis of the FDIC or that these thrift institutions simply be granted FDIC membership.

In fact, there was precedent for combining the two deposit insurance funds in some manner. In 1933 the mutual savings banks, recognized as a form of thrift institution, had requested and been granted permission to participate in the FDIC. In 1934, when Congress extended the temporary FDIC fund established the preceding year, it provided that "the Corporation, in the discretion of the board of directors, may open on its books solely for the benefit of mutual savings banks an additional Temporary Federal Deposit Insurance Fund (hereinafter referred to as the "Fund for Mutuals") which, if opened,...shall continue to July 1, 1935."

The Banking Act of 1935 provided for the consolidation of the "Temporary Federal Deposit Insurance Fund and the Fund for Mutuals" into a "Permanent Insurance Fund." However, the law also authorized the FDIC Board of Directors, at its own discretion, to create a separate insurance fund for the mutual savings banks. This was done in recognition of the special characteristics of the mutual savings banks that distinguished them from commercial banks.

Another factor which helps explain the absence of any proposal or discussion of a possible merger of the FDIC and FSLIC is that Congress clearly intended the two funds to be mutual and self-funding. Congress attempted to design the FDIC and FSLIC to have sufficiently large reserves and adequate examination authority and regulatory tools to weather all but the worst economic storms. Although Congress through the years did provide the FDIC and FSLIC with various forms of contingency funding, it designated the private capital markets and/or federal government loans as the appropriate outside sources of this funding. There was no discussion by Congress of resolving any emergency funding problems experienced by the FDIC or FSLIC through loans or grants from the other agency or through a merger.

Even when Congress discussed the impact that a full-scale economic disaster likely would have on the deposit insurance funds, there was no discussion of a possible merger between the FDIC and FSLIC. In 1950, House Banking Committee and floor debates on the Federal Deposit Insurance Act focused on what constituted an adequate level for the FDIC insurance reserves. Two fundamentally different perspectives on this question were represented in these debates. According to one of these perspectives, shared by such Banking Committee members as Congresswoman Woodhouse (of Connecticut) and Congressman Multer (of New York), Congress should attempt to ensure that the FDIC fund is large enough to cover any potential losses. Congressmen with the other perspective, including senior Banking Committee members Wolcott (of Michigan) and Brown (of Georgia), contended that it is unrealistic to attempt to maintain an insurance fund large enough to survive a truly devastating economic crisis. Congressmen with this view believed that massive federal government assistance to the FDIC probably would be required in the event of a full-scale depression. Ultimately, Congress opted for a possible federal government bail-out of the FDIC during a depression rather than the maintenance of a very large insurance fund during prosperous times.

Another factor that probably influenced the absence of Congressional interest in a possible merger between the FDIC and FSLIC funds was their financial health and smooth operations up through the 1950's. Between 1932 and 1950, Congress did not contemplate a situation similar to the one it is facing in 1989, namely an insolvent FSLIC and a solvent FDIC.

II. THE COMMERCIAL BANKING AND TRADITIONAL THRIFT INDUSTRIES BETWEEN 1933 AND 1950: CONGRESS MAKES A DISTINCTION

When in 1934 Congress provided deposit insurance to the savings and loan segment of the thrift industry, it established a totally separate fund -- the Federal Savings and Loan Insurance Corporation (FSLIC).

Congress very easily could simply have provided FDIC coverage to savings and loan associations or created a special thrift fund under the aegis of the recently established FDIC. Certainly, a precedent for incorporating the thrift fund into the FDIC had been established just a year earlier in the Banking Act of 1933. This Act authorized the participation of the mutual savings banks in the FDIC. And a subsequent act of Congress permitted the FDIC Board of Directors, at its own discretion, to establish a separate fund within the FDIC for the mutual savings banks. However, Congress did not even examine such options when it considered deposit insurance coverage for savings and loan associations and related institutions.

Perhaps the primary reason for the establishment of two separate deposit insurance funds, one for commercial and mutual savings banks and another for the savings and loan-type of thrift institution (and for the absence of any mention of a merger of the two funds) was the clear distinction that Congress made between the two industries in the 1930's. The structure and business function of commercial banks differed substantially from those of the savings and loan association and similar institutions. Moreover, the commercial bank and the savings and loan institution were viewed as playing very different roles in U.S. society. Commercial banks, which accepted demand and time deposits from individuals and businesses, supplied the business loans that kept the wheels of commerce turning. Savings and loan-type institutions, on the other hand, accepted share-deposits from savers, which were used almost exclusively to provide mortgage loans to homebuyers.

The distinction that Congress made between the commercial bank and the savings and loan-type institution was reflected in that body's failure in 1933 to recognize the adverse impact that the establishment of the FDIC would have on the flow of savings into savings and loan associations. In hearings on bank deposit insurance held in 1932 in the House Banking and Currency Committee and in Congressional floor debate on the Banking Act of 1933, no mention was made of the desirability of providing some form of federal deposit insurance to the savings and loan industry.

In this regard, Congressman Everett Dirksen of Illinois

noted in House floor debate on the National Housing Act of 1934, which established the FSLIC:

> "If memory serves me correctly, I recall that in the course of the discussion of the FDIC bill, in the spring of last year, there was no single allusion on this floor by any Member that ultimately there might be a stagnation in the mortgage-financing market, and yet that seems to be precisely what has happened...The result [of FDIC-insured bank deposits] is that the potential market for mortgage financing funds has been entirely drained."[1]

Between 1930 and 1950, Congress appreciated the differences between the commercial bank and the savings and loan, as well as the special role each played in the economy. During this period, Congress certainly did not promote or envision the homogenization of the commercial banking and savings and loan industries, or even of the savings bank and savings and loan industries.

The legislative history is sprinkled with references to the desirability of maintaining separate thrift and banking systems. For example, during the House floor debate on the Federal Deposit Insurance Act of 1950, Congressman Jesse P. Wolcott of Michigan, ranking Republican on the House Committee on Banking and Currency, made the following statement:

> "...We have had some trouble with some of the Federal savings and loan associations and the state-chartered building and loan associations holding out to the public that they are savings banks. They are not savings banks; they are lending institutions; they are thrift institutions which are doing a splendid job here in the United States today in home financing. They are restricted in the main to home financing; they are primarily lending institutions. A customer is not called a depositor in the building and loan and savings and loan associations for the reason that we do not want to give the impression that they are savings banks. They purchase certificates; and when they purchase certificates sufficiently, if their credit is otherwise good, they may make a loan for the purpose of building a home. I think we should keep the Federal savings and loan association in that field. I think we should keep the state-chartered building and loan associations in that field..."[2]

There is yet another related factor that may help explain the decision of Congress to create an FSLIC totally separate from the FDIC. In 1933, Congress created the Federal Home Loan Bank System, a system established specifically for the purpose of promoting mortgage lending. Since the stated purpose of the FSLIC was to encourage saving in traditional thrift institutions so as to promote mortgage lending, it made a great deal of sense to link the two by placing the deposit insurance agency under the aegis of the Federal Home Loan Bank Board.

III. THE ESTABLISHMENT OF THE FDIC AND FSLIC AS SELF-FUNDING INSURANCE CORPORATIONS: AN OBJECTIVE OF CONGRESS

The legislative history of the FDIC and FSLIC between 1932 and 1950 clearly establishes that Congress intended for them to be essentially self-contained and mutually funded by their own members. This factor also may help to explain why the idea of a possible merger of the FDIC and FSLIC was never discussed.

From the inception of the FDIC and FSLIC, Congress attempted to determine the kind of self-funding (capital and premium) structure that would provide the resources necessary to permit the FDIC and FSLIC to survive most, if not all, economic situations.

In House debate on the Banking Act of 1933, House Banking Committee Chairman Henry Steagall, an original architect of the FDIC, explained that "this bill seeks to establish a mutual insurance system supported and maintained by the banks themselves, in their own interests as well as for the benefit of their depositors."[3]

At hearings conducted in 1932 by a subcommittee of the House Banking and Currency Committee, Chairman Steagall made the following comments on the federal bank deposit insurance bill he had introduced:

> "...Since then [1930] the number of failures and deposits involved have been unprecedented. During the past 10 years 7,800 banks have failed, having deposits of $2,500,000,000. This is the worst period in history. Surely we shall not have another such experience. But the fund established by this bill would have been more than ample to have carried out the purpose contemplated over the last 10-year period. Surely if this be true we can not doubt that it will be sufficient to meet the exigencies of the future. We have every reason to hope that the recent wave of failures has spent its force."[4] and
>
> "Well, I have in mind, to be frank with you, that this fund is amply sufficient. I think we have every reason on earth to assume, or to believe, that the fund is amply sufficient, unless the world is coming to an end, and we do not seem to think it is, and I hope it is not..."[5]

Chairman Steagall clearly intended to establish a bank deposit insurance system that was self-sufficient.

Congress also designed the FSLIC to be self-funding. In floor debate on the National Housing Act in June of 1934, Senator Duncan Fletcher of Florida, Chairman of the Senate Committee on Banking and Currency, remarked:

> "This insurance [FSLIC] is made self-sustaining by regular insurance premiums paid to the Government by the participating building and loan associations ..."[6]

This conception of a largely self-sufficent federal deposit insurance fund that could survive difficult economic times as well as normal periods also surfaced in deliberations on the Banking Act of 1935, which made the FDIC a permanent agency. The report on the Banking Act of 1935 filed by the House Banking and Currency Committee states:

> "Under the annual assessment plan of title I a reserve fund will be gradually amassed to provide against periods when the Corporation might be called upon to pay large amounts of insured deposit liabilities."[7]

During House Debate on the Banking Act of 1935, Congressman Clyde Williams of Missouri, a senior member of the Banking and Currency Committee contended:

> "...It comes with very poor grace from the banks of this country to object to an assessment of one-eighth of one percent annually not only to take care of the current expenses and losses during normal times but it is hoped and expected to build up a reserve sufficient to take care of losses under abnormal conditions, during depressions and times of stress and strain."[8]

Moreover, when Congress considered the establishment of a premium rebate system for the FDIC in the Federal Deposit Insurance Act of 1950, it continued to view the deposit insurance funds as essentially self-funding, even during periods of economic difficulty. For example, according to the Senate Banking Committee's report on this legislation:

> "The committee desires to emphasize that the formula [for premium rebates] thus provides a flexible method for granting a reduction in the assessments paid by banks in normal years, and in bad years provides for payment of the full assessment if needed. This should reasonably protect the insurance fund in years of extraordinary losses."[9]

The concept of "self-help" underlying the federal deposit insurance funds also was raised during House floor debate on the Federal Deposit Insurance Act. Congresswoman Chase Going Woodhouse of Connecticut quoted FDIC Chairman Maple T. Harl during debate on the bill's provision to establish a

premium rebate system:

> "To eliminate or drastically reduce the contribution of banks to the insurance funds would be a departure from the concept of self-help which is a fundamental feature of the Federal Deposit Insurance System. Increased reliance on Government help is inevitable if the bankers' contribution is reduced beyond reasonable levels...if free enterprise in banking is to continue, deposit insurance must remain predominantly an instrument of self-aid and the banks must be willing to foot the bill."[10]

Of significant importance were statements made during the debate on the Federal Deposit Insurance Act of 1950 concerning the possibility that the very healthy FDIC reserves might be "raided" by the federal government, if they were allowed to grow much larger. These statements (and subsequent Congressional approval of a premium rebate system for FDIC members) imply a Congressional intent that the FDIC fund should not be used by the federal government for purposes other than the insurance of FDIC members' deposits. The preservation of the FDIC's integrity was regarded by some members as a "sacred trust". Under no circumstances were its reserves to be "raided" for other uses.

For example, Congressman Paul Brown of Georgia, a senior Democrat on the House Banking Committee, maintained during House debate on the Act:

> "...its [FDIC insurance fund] safety or guardianship is a sacred trust. We must always be aware of any attempt to raid this fund either directly or indirectly, such as attempting to alter in any way the independent status of the FDIC."[11]

And Congressman Fred Crawford of Michigan contended:

> "Here is a formula [for premium rebates] that protects the FDIC; it protects its operations; it also prevents a fantastic fund being built up that somebody some day can reach in on and grab. I can imagine our getting into a situation where we would reach in and grab the social security reserves, the civil service retirement reserves...If the Government wants those things, it can take them in the easiest manner possible...If we build up great reserves, you will have somebody some day trying to reach in and grab them."[12]

During these discussions of the importance of protecting the FDIC funds from use by the federal government for purposes other than the insurance of bank deposits, no one mentioned the possibility that one day the government might consider using FDIC funds to bail out an insolvent FSLIC.

It is unlikely that Congress between 1932 and 1950 could have conceived such a scenario. Both the FDIC and the FSLIC were viewed as healthy, well-managed deposit insurance funds during this period. In fact, at least one Congressman who served in 1950 believed the FSLIC to be in better shape than the FDIC. Congressman Abraham J. Multer of New York, a Democratic member of the House Committee on Banking and Currency, stated during the House floor debate on the Federal Deposit Insurance Act:

> "The Federal Savings and Loan Insurance Corporation and its members are seeking no cut in their assessments or premiums [as were the commercial banks]. They pay the same rate of one-twelfth of one percent that the member banks of FDIC have been paying up to now. Their fund comparatively speaking is stronger than the FDIC fund...Most of their money is invested in mortgages secured by the homes of our American people. Outside of Government securities they are the soundest investment ever produced in this country."[13]

IV. CONTINGENCY FUNDING FOR THE FDIC AND FSLIC: CONGRESS TURNS TO FUND MEMBERS, THE PRIVATE CAPITAL MARKETS, AND THE U.S. TREASURY

Although Congress between 1932 and 1950 intended the FDIC and FSLIC to be adequately funded to handle problems during both normal and difficult economic times, it did recognize the appropriateness of providing for contingency funding. During this period, Congress provided that the FDIC and FSLIC could obtain this emergency funding in several ways: through assessing additional or special insurance premia (or stock); by issuing debentures or similar instruments in the private capital markets; and/or by borrowing from the Federal government.

Interestingly enough, during hearings in 1949, Congressman Wright Patman of Texas inquired about the possibility of authorizing the Federal Home Loan Banks (no mention of FSLIC) to borrow from the Federal Reserve rather than from the U.S. Treasury. However, no one even raised the proposition that the FDIC be authorised to borrow or receive grants from FSLIC, or vice versa. Of course, since Congress considered commercial banks and traditional thrifts to be separate industries and the insurance funds to be "mutual" in nature, the absence of any discussion of such proposals is understandable.

From 1933 through 1950, Congress authorized various specific forms of contingency funding for the FDIC and FSLIC.

The Banking Act of 1933 authorized the FDIC to issue notes, bond, debentures, and other similar obligations. It also authorized the FDIC to require members banks to pay in an additional amount of stock, if necessary.

The 1934 act extending the temporary FDIC fund required the Reconstruction Finance Corporation (RFC) to purchase or hold up to $250,000,000 of FDIC obligations, at the request of the FDIC Board of Directors. The Banking Act of 1935 further provided that if for some reason the RFC was unable to purchase the full amount of such obligations, then the Treasury Department was obligated to purchase the balance. Moreover, the Treasury Department was required by this law to buy an additional $250,000,000 of FDIC obligations, if requested.

The National Housing Act of 1934 authorized FSLIC to issue notes, bonds, debentures, and similar obligations. It also authorized FSLIC to charge special assessments, which were not to exceed one-eighth of one percent of the total amount of insured members' accounts and creditor obligations.

In 1947, Congress passed legislation providing for the retirement of the FDIC's capital stock (subscribed by Treasury and Federal Reserve Banks when FDIC established) which also authorized the FDIC to borrow up to $3 billion from the U.S. Treasury. This line of credit was authorized not because of problems the FDIC was facing. In fact, both the FDIC and the commercial banking industry were in good shape in 1947. Rather, this borrowing authority was designed to help maintain public confidence in the FDIC as the Corporation retired its government-subscribed capital stock. Maple T. Harl, then Chairman of the FDIC, who proposed the Treasury line of credit at a hearing of the Senate Banking Committee, offered the following rationale:

> "The situation is this: At the present time some people have the idea that this capital is being paid off and the Government is getting out of the FDIC. Psychologically if people think the Government is getting out, they will worry. As you know we have a borrowing authority of half a billion dollars from Treasury, or the RFC. We would recommend that that be repealed and the borrowing authority from the RFC be repealed, likewise the half billion from the Treasury and in lieu thereof we be allowed to borrow when and if necessary three times our asset position, which if it was a billion we would have a call of $3,000,000,000 on the Treasury for these unforeseen contingencies such as we had in 1932...but we think the banks are in a very very strong position."[14]

In 1950, Congress passed legislation authorizing FSLIC to borrow up to $750,000,000 from the U.S. Treasury. This legislation was not passed in response to an existing crisis facing the FSLIC. Rather, it was passed in response to a perceived need to put the FSLIC on equal footing with the FDIC, with respect to federal government support during a crisis. According to the Senate Banking Committee report on the legislation:

> "This provision for Treasury loans is comparable to that provided for the Federal Deposit Insurance Corporation...approved August 5, 1947, which authorizes that Corporation to borrow up to $3,000,000,000 from the United States. This is about three times the amount of the present accumulated fund of the FDIC. The provisions...would make available resources for use in any possible future emergency to enable the Federal Savings and Loan Insurance Corporation to maintain the confidence of the public in their investments in insured savings and loan associations."[15]

Although Congress at this time also considered the elimination of FSLIC's authority to require the payment of "special assessments", it decided to retain this authority. According to the Senate Banking Committee report on the bill, the committee felt "that the authority for additional premium assessments should be retained against the contingency that exceptionally heavy losses may be encountered in future years."[16]

While Congress provided both the FDIC and FSLIC with mechanisms for obtaining emergency funding, these funds were not necessarily intended to provide the FDIC and FSLIC with sufficient resources to weather another 1930's style depression. Interestingly, in the 1930's, there appeared to be a general consensus among Banking Committee members and bank regulators that a recurrence of the banking debacle of the 1930's was very unlikely. However, Congress did recognize that the federal deposit insurance funds should have supplemental sources of funding to ensure their ability to cope with any extraordinarily difficult situation that might arise. House Banking and Currency Committee Chairman Henry Steagall expressed this perspective in a 1932 hearing on bank deposit insurance:

> "...but I will say this to you: I recognize that the important thing, if we are going to have a guaranty system, is to let the public understand that it is ably equipped to take care of any situation that may develop; and with that end in view, I have in mind an amendment to this bill that will supplement its resources."[17]

At no time in the 1930's did Chairman Steagall or any other member of Congress recommend a merger of the FDIC and FSLIC, or any other kind of financial arrangement between the two funds as a means of supplementing the funds' resources. Nor was there any discussion of placing legal restrictions on such actions.

On the other hand, Congressional debate on the Federal Deposit Insurance Act of 1950 contained considerable discussion of whether or not it was necessary to build an FDIC fund large enough to withstand a full-fledged depression. These discussions provided a perfect opportunity to propose a merger or other financial arrangement between the FDIC and FSLIC, if justified by economic conditions. They also provided an opportunity to propose legal restrictions on these types of arrangement. However, such proposals were never contemplated. Instead, Congressional discussion focused on the probability of financial assistance from the federal government should the resources of the FDIC prove insufficient to weather a full-scale depression. And in the end, Congress concurred with those members who contended that even an FDIC with realistically large reserves probably would require federal government assistance during a serious depression.

NOTES

[1] U.S. House of Representatives, 73rd Congress, 2nd Session, *Congressional Record*, June 12, 1934, p. 11200.

[2] U.S. House of Representatives, 81st Congress, 2nd Session, *Congressional Record*, July 20, 1950, p. 10727.

[3] U.S. House of Representatives, 73rd Congress, 1st Session, *Congressional Record*, May 20, 1933, p. 3837.

[4] "To Provide Guaranty Fund for Depositors in Banks", Hearings Before the Subcommittee of the Committee on Banking and Currency, U.S. House of Representatives, 72nd Congress, 1st Session, March 14, 1932, p. 5.

[5] *Ibid.*, p. 55.

[6] U.S. Senate, 73rd Congress, 2nd Session, *Congressional Record*, June 16, 1934, p. 12012.

[7] House Report No. 742 [Banking Act of 1935], Committee on Banking and Currency, U.S. House of Representatives, April 19, 1935, p. 2.

[8] U.S. House of Representatives, 74th Congress, 1st Session, *Congressional Record*, May 3, 1935, p. 6905.

[9] Senate Report No. 1269, Committee on Banking and Currency, U.S. Senate, February 10, 1950, p.7.

[10] U.S. House of Representatives, 81st Congress, 2nd Session, *Congressional Record*, July 20, 1950, p. 10729.

[11] *Ibid.*, p. 10729.

[12] *Ibid.*, p. 10730.

[13] U.S. House of Representatives, 81st Congress, 2nd Session, *Congressional Record*, July 19, 1950, p. 10659.

[14] "Federal Deposit Insurance Corporation," Hearings Before the Committee on Banking and Currency, U.S. Senate, 80th Congress, 1st Session, May 12, 1947, p. 11.

[15] Senate Report No. 1536 [to accompany H.R. 6743], Committee on Banking and Currency, U.S. Senate, May 5, 1950 [as found in U.S. Code Congressional Service, 81st Congress-2nd Session, 1950, Volume 2:Legislative History, p. 2591].

[16] *Ibid.*, p. 2592.

[17] "To Provide Guaranty Fund for Depositors in Banks," Hearings Before the Subcommittee of the Committee on Banking and Currency, U.S. House of Representatives, 72nd Congress, 1st Session, March 14, 1932, p. 55.

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Senate and House Floor Proceedings, Congressional Record, March and July 1950.

The **Chairman**. Thank you very much.

Senator Pressler has joined us. Senator Pressler, did you have an opening comment to make this morning?

Senator **Pressler**. I have no opening statement.

The **Chairman**. Senator Dixon has had to go to the floor. He's a member of the Armed Services Committee on the Tower nomination. He may return a little later.

Let me ask each of you in order, Mr. McKinney, starting with you, what is the single most important item in the administration's bill that you think needs to be changed or modified?

Mr. **McKinney**. I guess I would come down on the side of supervision, that a clear distinction would be made and things would be put into place, which I believe they are, under the new bank insurance fund, the savings association insurance fund, having the Federal Home Loan Bank Board come under Treasury, and then to get on with beginning to apply the same standards to the S&L side as are applied to the bank side—to start that process. At the same time that that's going on, to begin to immediately close the S&L's that should be closed, to clear up the market confusion, and put some teeth in it under the criminal section.

So I would come down to all the things I mentioned under supervision to get the process moving that eventually would lead—and I think the target is June of 1991—to where the two industries would almost be mirror-like, and I think the first requirement is supervision.

The rest is technical and I think could be fine-tuned. So I would come down on the supervision side.

The **Chairman**. Mr. Osteen, what specifically do you put at the top of your list of things that you think need changing in this package?

Mr. **Osteen**. Mr. Chairman, I think we've talked a lot about the attraction of capital and the need for it and I would say the single most important element of change needs to be the standardization of capital requirements among all financial institutions.

Granted there are some things that need to be accommodated because of past practices and past urgings of the Federal Home Loan Bank, but I would say that uniform risk-based capital applied consistently to all insured depositories is an absolute necessity.

The **Chairman**. Doesn't that also argue for aiming for at least implicitly a similar kind of insurance premium process? Wouldn't we end up under that kind of a situation having essentially equivalent insurance costs charged to individual institutions within one system or the other?

Mr. **Osteen**. Yes, sir. That would eliminate the argument for a difference.

The **Chairman**. Do you envision that, Mr. McKinney?

Mr. **McKinney**. Eventually I would. After a period of time that the process has to go through in order to reach that level, and I believe the 2-year timeframe is a tight timeframe, but I think it can be done. So during that 2-year timeframe, it should not be similar. Both funds have to have their own objectives—FDIC with its 1.25 percent and the FSLIC doing what it has to do to begin to clean it up. Then during that time they will come up to a point where you could have a common premium, providing that the standards were the same, supervision was the same, and they were mirror-like financial institutions. And that I would hope would be within 2 years.

The CHAIRMAN. A number of the bankers that I've talked to don't feel terribly badly about the fact that the S&Ls are going to have to pay a higher insurance premium, but they would feel terribly badly if they had to pay a higher one than is proposed in the administration's plan.

Such premiums may or may not affect you directly, but they certainly affect a lot of the players in the banking game. So you don't mean by that that you don't envision that when you get a standardized premium that it might in fact even have to be higher if the risk profile is higher, not that you'd like to see that, but——

Mr. MCKINNEY. I would say that during this 2-year neck-of-the-hourglass, as we're passing through the neck of the hourglass, that hopefully by June 1991 that those type of things will have been managed to the point where on the banking side the 1.25 percent I think is very acceptable. So once that target is hit on the banking side, then the premiums should be reduced rather than a rebate—and that's another whole issue. I think Chairman Seidman has said that had the banking side not experienced the rebates that we wouldn't need the increase in premiums today.

So let's say the banking side hits the 1.25 percent and as long as it's maintained at the 1.25 percent the premiums could be adjusted. If the Third World debt then would have to come in and that would cause certain banks to not make it which would trigger an FDIC involvement that would lower the 1.25 percent, then those premiums would have to be increased for the whole population to get it back to 1.25 percent.

On the other side, that is a different kettle of fish and I would think it would have to work itself through on the FSLIC side during these 2 years with the problems to the point where the examination reports, et cetera would be mirror-like with the banking industry and then it could be similar.

Now if you merge the funds at that point, I think that's a different debate. If you merge the funds, then the premiums would have to be spread over a larger population in order to help but a handful of banks that would have Third World debt. So the merger of the funds I think is a separate issue, whether or not it should or should not be merged in let's say 1991 or 1992.

As far as the premiums being the same and the same standards but with different funds, that could be achieved or attempt to be achieved in 1991. If it works, then maybe in 1992 put them together.

The CHAIRMAN. If my colleagues would allow, I think Mr. Zwick ought to have an opportunity to answer the same question.

Mr. ZWICK. Mr. Chairman, I think we're in general agreement as I heard the comments of my colleagues here. The important thing is to get the insurance funds on a businesslike, actuarial basis. We should not use the insurance fund of one industry to tax that fund to support another industry.

The CHAIRMAN. Well, that's not part of the plan. Going back to my original question, what do you put at the top of your list of things in the plan that need adjusting?

Mr. ZWICK. The most important thing is to get bank capital flowing into the thrift industry, as Senators D'Amato and Garn have said. There are a number of provisions within the administration bill that delay it for 2 years, that treat banks differently than other parties that can get into the thrift industry. Those are unfortunate impediments to opening up this flow of capital.

The CHAIRMAN. Very good. Thank you.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Mr. McKinney, I'm going to ask you a question that you can't answer because no one has answered my question yet and I am convinced the reason being that there is no good answer, and that's why all of the experts that have been before this committee have not answered. You may not be surprised that this gets into where you say strengthen the thrift regulatory structure. The well-documented failures of the current thrift regulatory system call for major change. Agreed. Motherhood—all of us agree with that.

Then it says to eliminate the current disparity between banks and thrifts regulation. OK. I agree with that. The ABHC strongly supports having both the chairman of the Federal Home Loan Bank Board and Comptroller of the Currency report to the Secretary of the Treasury.

How does one do that? By merely transferring it to the Secretary of the Treasury, how does that eliminate inequities, and contribute to uniformity, safety and soundness? When I first saw this provision I asked myself that question. This was before the administration ever came out with the plan. It was when we were having discussions and I asked them, "What does that do?" We want an independent, changed regulatory board. We want the insurance function separated. We want to improve supervision and all of that. So we agreed. How does it accomplish any of those things by putting it under Treasury? They didn't have a good answer. They still don't have a good answer. The herd instinct is rampant. Everybody comes in and says this is how we're going to do it.

So I would like a specific answer of how this eliminates the disparity, how it increases safety and soundness, equity, uniformity and all of that by putting it under Treasury.

Mr. MCKINNEY. Senator, I will attempt to give an opinion. We have a system that is underway and seems to be working on the bank side. The Comptroller of the Currency in my experience has very good examiners, very thorough, very professional, and they have standards. They are now in Treasury and the system is working.

We have a system that seems not to be working on the S&L side and as a first shot at it you take their examination arm, FSLIC and the Federal Home Loan Bank Board, and duplicate it into something that does work—currently Treasury. It could have been something else.

Senator GARN. OK. Let me pursue that. The Comptroller has lost a lot of people to FSLIC. Do you know why? Because in 1985 they changed the regulatory structure. The criticisms can be made about FSLIC primarily antedate 1985 because this committee authorized vastly increased hiring of examiners and paying them a lot more. A lot of those were hired away from the Comptroller because the Comptroller under Treasury has pay caps and the Comptroller sat there and testified that he would like to have the flexibility to be able to do some of the things the Federal Home Loan Bank Board has been able to do. And I think what we're dealing with here that really puzzles me—I didn't start out feeling so strongly about this issue, but every day it grows—is that I like reasons for doing things, and I can't get any good reasons and that disturbs me.

The Comptroller has a different function. He doesn't have a housing component, does not have 12 regional banks around the country that are capitalized in and of themselves and owned by their member banks and so on. And it's an issue that has been reviewed over the last 10 years—the Fine study, the Hunt Commission—and recommendations have been made to take the Comptroller away from Treasury so that it is truly independent. I'm not going to take the time, but there is evidence of when Secretaries of Treasury have tried to interfere with the Comptroller.

Now I happen to think that wherever regulation comes from, it ought to be independent. It should not be subject to political whims. And I think the only thing that Treasury adds to me is the possibility of political accountability and I think the issue is independence—a newly formed Federal Home Loan Bank System that is independent of the industry and the influences we've heard about in the past. It seems to me that Treasury at least gives the possibility of political influence which we would like to avoid.

So I really don't understand the direction we're going in because the arguments you, the administration, and the witnesses yesterday are making could then be applied to the FDIC. The FDIC lost $4.2 billion last year, 25 percent of their assets. They are not the white knight in shining armor that everybody makes them out to be. They've got problems all by themselves. That's why you're going to pay an increased premium, totally apart from the thrift crisis.

So I can make an argument out of all the arguments of putting the Federal Home Loan Bank Board under the Treasury. The FDIC needs to have political accountability and on that theory if there's one regulator that really should have political accountability it's the Fed. They have a regulatory function. More importantly, they play with the money supply. They set monetary targets. They set the discount rate. Wouldn't you like to have Treasury right now? You know Jim Baker when he was there didn't like it and they fuss and feud with the Fed in the newspaper. They're doing it right now. They don't like Greenspan tightening credit. So if we're going to have political accountability I guess—and I don't know whether Lindy Marinaccio would like to have had the SEC under Treasury, but they're a regulator of the securities industry.

I don't think that there's a case to be made that this solves the problem. We agree on what the problem is. We agree on a solution of independence. But I wish somebody could give me a good reason—I don't think they can. I've tried for 2 weeks and nobody has been able to come up with one even when I give them a chance to go back and study. There is not a justification to go to Treasury. If there is, then we'd better round up the FDIC, the credit unions, the Fed and the SEC and give them all to the Secretary of the Treasury so that we can have another level of oversight.

Mr. ZWICK. Senator Garn, may I comment briefly?

First is the issue of consistency across the depository institutions and I think your comments are consistent with that, that we ought to have a consistent overview of the banking industry, the thrift industry and credit unions.

Now whether or not they should be in an independent agency or within the Treasury, as a former budget director, let me tell you, sir, the administration always tries to put it within a department and Congress always tries to——

Senator GARN. They do it so that OMB can dictate the salaries. Senator Riegle and I fought that battle to get the Federal Home Loan Bank Board out of that so they weren't like the Comptroller.

Mr. ZWICK. All I am suggesting, sir, is that that's an honorable debate that's gone on for at least 100 years between Congress and administrations, and I assume that debate will continue for the next 100 years.

Whether it's an independent agency or part of the Treasury, we, the banking industry, feel that the processes ought to be consistent across the thrift industry, the banking industry and the credit unions.

Senator GARN. I agree with you. As a banker, wouldn't you feel that you would like to have an independent regulator, whatever that regulator is, apart from political accountability? I would if I were out there running a bank or an S&L.

Mr. ZWICK. That's right, and it's not quite clear which is less independent of political influence.

Senator GARN. My time is up.

The CHAIRMAN. Well, I think we ought to take the time to let the others respond, but it was interesting. I thought your answer which sounded like an old budget director, that's not surprising.

Mr. ZWICK. That's right.

The CHAIRMAN. But anyway, that was a nice piece of broken field running but did not really answer the question in terms of what the gains are that one gets by going to the other structure.

Senator GARN. With an answer like that he could be on this side of the table.

The CHAIRMAN. Mr. McKinney, Senator Garn addressed his question to you and if we can I think we ought to let both of you respond as well to his comment.

Mr. MCKINNEY. Again, I can only offer an opinion and try to frame that opinion in the current crisis that we are all living in. I think we have to do something fairly quickly. I don't know if we have the luxury of designing the perfect system. Therefore, we do have a system that currently kind of works. Why not capitalize on that system, solve the problem, and then 2 years from now maybe address a completely new way to do it if that could be possible.

Senator GARN. Well, that's a good general thought again. I don't disagree with the general thought. But it still doesn't address my question. You can do it just as quickly leaving it independent as you can putting it under Treasury.

Mr. MCKINNEY. Then the only 2 points I would make and then I'll pass it on. One has to do with Charlie Zwick's idea that whatever is done, if both are under Treasury or if they are not, they should be both under something, the same head, so that we could have uniformity and standardization.

The other thought that I would offer is that since the funds are in effect backed up by the taxpayers, there is accountability there. So if a new independent agency is created, how will that then be looked at? Because if they misbehave, the taxpayer can bail them out. So how do we bridge that gap to have everybody happy with what's going on, given the fact that if it doesn't work the fallback position is back to budget.

Senator GARN. Independent agencies get out of line, I'll guarantee you. Congress is here. I have been a part, as a member of the Appropriations Committee, of cutting off funds for various independent agencies who were not doing what we thought they ought to do. We fought that battle with the Federal Trade Commission. We've threatened other agencies. An independent agency is not going to run wild.

Mr. OSTEEN. Senator, I would appreciate an opportunity to respond to your unanswerable question.

I can speak only from a pragmatic, practical, day-to-day operating perspective. I spent 16 years in the banking industry and I'm now moving up on my 8th anniversary in the thrift industry.

We, as an association, have come to the conclusion that the regulatory function oversight of federally chartered thrifts should be under Treasury. We haven't addressed this Federal Reserve Board business. I would, off the top of my head, disagree strongly that the Federal Reserve Board should continue to be a separate agency.

However, I think we have asked a Federal apparatus, an agency, to do something for which it was totally ill-equipped. In the 8 years that I have dealt with the Federal Home Loan Bank Board and the Federal Home Loan Bank System, I have come to the conclusion that the operating inefficiencies introduced into our banks and our savings and loan associations by an agency that obviously was set up to administer one type of institution and has been asked to administer a different type of institution in a totally different financial services marketplace is creating operating problems that can best be addressed by an agency that has a substantial amount of experience.

Senator GARN. I agree with you. You're making the same point that I've always agreed to and I stipulated at the outset. It needs to be changed. That is not the point. Treasury has no expertise in regulating banks or savings and loans, absolutely none. They have a Comptroller of the Currency who happens to be under them, but Treasury has no background, no experience, no staff. So I'm sorry, but there is still no one who can answer the question. All of you are trying and you go all around why it should be changed, but you can't give me a justification that exists in fact of what Treasury does to make it better.

Mr. OSTEEN. I hope that Treasury, with the experience of the Office of the Comptroller of the Currency would impose some——

Senator GARN. The Comptroller is not going to tell the Federal Home Loan Bank chairman what to do. They have already testified to all of that and everybody testifies that they are different and can't be molded the same because of the 12 regional banks and the housing function. So if that's the case, then we don't need it. We just let the Comptroller do both.

Mr. OSTEEN. We are yearning—those of us being regulated right now are yearning for some consistency, some stability, and some viability that hasn't existed certainly in my 8 years of being regulated by the Federal Home Loan Bank and we are looking to this as a solution. We are looking for a regulatory apparatus that is better suited to the regulation of our industry.

Let me give you one example of the frustrations that we face out there. We did a supervisory merger of an institution wherein we had $8 million in cash ready to invest in an institution that had a negative net worth. It took 9 months for the Federal Home Loan Bank to allow my institution to make that investment and not until we came to Washington and we said, "Please do it at the end of the quarter," the question came back from the head of securities at that agency, "What's so important about the end of a quarter?" And as an SEC regulated company we did explain that, but it took 9 months for the privilege of investing $8 million in a negative net worth company. That's just an example.

Senator GARN. I've asked the chairman to skip my next turn because I've taken both my turns in one. I appreciate his forbearance.

Mr. OSTEEN. That's a bad word, Senator.

Senator GARN. I can give you horrible examples of that. Still you haven't answered my question. What will that change? We must improve that agency, but you still can't answer my question that just a transfer to the Treasury Department will make that change. You have to change the agency, and putting it under Treasury has nothing to do with the internal changes of that regulation and will add nothing to it. I've got to stop. I've got other colleagues.

The CHAIRMAN. I think it's important to take the time we need, whoever it happens to be—I especially feel that way with Senator Garn, but I will with all colleagues—whenever we're at a point where there's something that is of particular major importance to them and on the issue generally.

I want to just make two acknowledgements. One is that for the benefit for those here this morning and anybody in the press, we did print in yesterday's Congressional Record the section-by-section version of the bill. So that is there as a reference for all who wish to have it.

Also, I want to acknowledge the presence of Mr. Lud Ashley, our former colleague in the House, who had a very distinguished record of service there and very importantly in the banking and housing area. We're delighted that he is with us in the committee room today.

With that, Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

I want to change the focus of the discussion for a few minutes over to the capital area which a couple of you have mentioned in your remarks.

I have been approaching this proposal that we received from the administration from the viewpoint that the direction in which we're heading with respect to capital was to get all institutions up to roughly 6 percent capital. That's the way it's been kind of talked about around the committee.

I picked up, Mr. Osteen, from your comments the Basel agreement executed and just signed I guess in 1988 by Western industrial nations, which as I understand it, calls for a risk-based capital structure.

Mr. **Osteen**. That's correct.

Senator **Mack**. My question then is, will the Basel agreement be used to determine the capital requirements of the thrift industry? Again, my feeling was that we were heading towards 6 percent as the capital base, but I'm starting to get the feeling that maybe it's not quite right, that where we're heading is towards the Basel agreement which as I understand it if a thrift was overwhelmingly involved in mortgages their capital requirement then would be 4 percent. And I would be interested in the reaction of all three of you whether you disagree with that or where you think we're going to end as far as this legislation is concerned, or do we need to be more specific in the legislation in outlining exactly what we mean by equal capital requirements?

Mr. **Osteen**. Our proposal is that we be very specific in this legislation and impose uniform risk-based capital requirements in accordance with the Basel Accord, which if you were overwhelmingly in mortgage-backed securities and one to four family housing, then your capital requirement would obviously be less. If you moved away from that to a higher level of commercial real estate loans or corporate loans or consumer loans, you could very well be higher than 6 percent. It would depend on your asset structure and we think that has an awful lot of merit and runs to the very root of the problem we're facing and that of recognizing the differences in risk levels in different balance sheets. And we think it ought to be established in this legislation very specifically and that everybody plays under the same rules with the exception of allowing some of these folks that have good will that was put on in good faith at the urging of the Federal Home Loan Bank or in supervisory cases have some transition period to get that off.

Mr. **Zwick**. Well, Senator, I agree very much with what Mr. Osteen just said. We need some ground rules. As you know, we just acquired a $1.4 billion S&L and under the agreement with the Federal Reserve Board we will bring that up to 6 percent tangible capital by the end of 1989. On the new risk-based asset criteria, we will have 12 percent capital at the end of the year. That I would suggest is making it difficult for commercial banks to acquire thrifts that need to be acquired.

So we need some explicit rules put in place that will be applied across all institutions, whether they're independent or parts of the executive branch, Senator Garn. So that we're not being skewered on one set of criteria or another and I think I agree completely with what Mr. Osteen said.

Senator **Mack**. If I could, Mr. McKinney, before you respond, if I could go back to it, would you run through those numbers again about the 12 percent capital and why?

Mr. **Zwick**. Well, very simply, the Federal Reserve Board will require us to have 6 percent tangible capital, subtract out goodwill first, and if you went and applied the risk-based capital since we got essentially mortgages in that institution, you'd only have to have half the capital. So essentially what becomes 6 percent on tangible capital total assets is 12 percent on risk-based criteria simply because of the weighting for mortgages versus commercial loans.

Senator MACK. OK. So then you agree with Mr. Osteen that there should be something more specific in the bill with respect to capital requirements?

Mr. ZWICK. Yes, and consistent.

Senator MACK. Mr. McKinney.

Mr. MCKINNEY. I would agree in part with my two colleagues, and that is that your question was should there be something specific in the bill. I would raise the issue of whether or not specific capital ratios should be in a bill that becomes law versus language to the effect that risk-based capital based on risk-based assets, etc., that is determined during the course of various periods, quarters or years or whatever, by an independent agency like the Federal Reserve Board—that's their mission in life—is to constantly study that and then come out with these capital guidelines—that's the type of language that might be included and require that it must be uniformly applied to both industries.

Senator MACK. I wonder if I might be able to follow up on that.

The CHAIRMAN. Yes.

Senator MACK. Mr. McKinney, again, I think the real thrust of my question, though, was not so much the specifics being written in but as to this whole confusion over whether we're really heading towards the 6 percent capital base or whether we're really heading towards the Basel agreement, which as I understand it, would say to those thrifts that remain primarily as mortgage lenders that your capital base really is 4 percent that you're striving for, not the 6 percent that has been implied or written into this bill by 1991.

Mr. MCKINNEY. I agree with you. I think that it has to conform with the definition of risk-based capital and then the managers of these various institutions, then it's up to them to determine what type of business they want to get into and that would dictate under the risk-based capital guidelines what their capital would be.

Senator MACK. Thank you.

The CHAIRMAN. Thank you, Senator Mack.

Senator Cranston.

Senator CRANSTON. Thank you very much, Mr. Chairman.

I welcome you and I appreciate this opportunity to hear your thoughts.

The FDIC Chairman, Bill Seidman, before the House Banking Committee recently said, "Because of the Bank Holding Company Act restrictions on mixing finance and commerce, banks have a smaller field than S&L's through which to seek potential buyers. This puts banks at a competitive disadvantage and bastardizes, if you will, the traditional wall—the wall has been torn down."

Given the need to attract new sources of capital to all types of depository institutions at this time, do you think we should acknowledge the changing complexion of the marketplace and put in place a structure that will encourage capital formation while enhancing supervision of the depository institutions? If any one of you would comment on that.

Mr. McKINNEY. Senator, the Association of Bank Holding Companies introduced a bill, H.R. 3360 I believe, which was the Financial Services Holding Company idea, which addresses I believe the topic which you just raised.

The difference between the Association of Bank Holding Companies position is Financial Services Council—is theirs includes commerce and we do not. That's basically the difference.

What we had said then is that you take a holding company that would be unregulated by the Fed, for instance, and it would be called a financial services holding company. It then would have parts that would be functionally regulated. It would have a bank holding company part regulated as bank holding companies are today. It would have a savings and loan holding company part regulated the way they are today. Then they would have insurance, real estate and securities. Those were the five fields that we had talked about a couple years ago.

If that would happen, I believe that it would begin to address freeing up the marketplace, to permit people to form financial services holding companies. They could get into the regulated businesses under the unregulated financial services holding company. That I think would be a big breakthrough to attract capital into this industry.

We also stated that if that would happen, then the savings and loan part would be exactly as they are today with all of their powers, rather than have the Federal Reserve Board at the holding company level impose the 4(c)(8) laundry list. That's why we wanted that eliminated.

The Federal Reserve Board still would regulate the bank holding company part, but the S&L part would be freer, if you will, which theoretically would attract capital into acquiring these various entities.

Senator CRANSTON. That's helpful and I appreciate it. Senator D'Amato and I reintroduced the Depository Institution Affiliation Act yesterday and its number is S. 530. I'd appreciate it if you would take a look at that and give us your thoughts on that in writing. Senator Garn was a cosponsor of it also.

What types of corporations, if any, should be excluded from the bidding process of thrifts and why, if you feel any should be excluded?

Mr. OSTEEN. Senator, it's our opinion that no individual segment of this economy should be excluded from the opportunity of investing equity capital into thrift holding companies or their underlying thrift institutions. We think this is logical in that if we adopt the idea of functional regulation that the institution would indeed be regulated by designated Federal agency, that the ownership of that individual depository institution should not be limited necessarily to financial institutions.

Senator Riegle has a great example of that in his home State. One of our members, Ford Motor Co., has put substantial capital into this industry and if we properly structure this particular piece of legislation I suspect that substantial more capital will be flowing from Ford Motor Co. and I see no conflict of interest or anything that would change our thinking as far as excluding the Ford Motor Co. from participating in the financial services industry.

Senator **Cranston**. Thank you very much. I have no further questions.

The **Chairman**. Thank you, Senator Cranston.

Senator Graham, you may want to make any opening comments too at this point, in addition to getting into questions.

Senator **Graham**. Thank you, Mr. Chairman. I do not have an opening statement, but I would like to ask a few questions.

Mr. Zwick, I want to thank you for your sharing the very thoughtful statement with the committee. I would make the same statement to Mr. McKinney and Mr. Osteen if they lived in Florida as well.

I was interested, Charlie, in your statement on page 15 relative to whether the increase in FDIC insurance premiums was a function of the actuarial need or a means of generating revenue to offset the expenditures for the FSLIC thrift bailout.

I asked a question yesterday of the president of the ABA as to whether he felt that that insurance premium increase was actuarially justified. He indicated that the ABA has not researched that question and that they would attempt to give us an informed response.

On what basis have you raised the question of the rationale for this increase?

Mr. **Zwick**. Well, our concern, Senator Graham, is that the assessments be based on actuarial needs of the various insurance funds and we observe with interest several factors.

First, the FDIC is down from its historic norm so you could make an argument that its assessment should be increased. We observe, though, the increase was tied to a FSLIC/thrift issue, which raised the question I think in reasonable thinking people's minds that it was introduced as a way to offset the budget impact rather than as an actuarially sound requirement.

In our testimony today we raised the question, since this is a business enterprise sort of thing, whether that shouldn't be off budget. The idea is that the amount of moneys that you raise into your insurance funds and the amount of monies you spend out of those insurance funds do not impact the deficit calculation, which is a very important but separate issue.

Senator **Graham**. I would be interested if your organization independently or in conjunction with the ABA could look at the assumptions behind the administration's recommended increase in the FDIC insurance premium to see what your conclusion is as to whether it's actuarially justified.

Mr. **Zwick**. We will be happy to do that and submit it in writing to you.

Senator **Graham**. Thank you. One of the issues that has been raised that relates to this is whether the depository insurance funds should have the authorization to adopt risk-based insurance premiums. FSLIC has testified that they believe they do not have such authority at the present time. I believe FDIC has testified that it believes it does have such authority, although I am not certain of that statement.

Do you believe that the Federal deposit insurance funds should be in a position to adopt a risk-based premium policy?

Mr. **Osteen**. Senator, I'll respond by saying that if we adopt, as has been recommended, the Basel Accord risk-based capital standards, then that indeed would be a proxy for risk-based premiums and you probably do not need both.

Mr. **McKinney**. I would agree with that. I think that balance sheet discipline and capital ratio discipline, coupled with a new level of examinations and standardization, would be the type of market discipline which will work, rather than also having an outside agency come in and determine whether or not you are or are not a premium institution. I think it would drift from the market forces. So I would agree with Mr. Osteen.

Senator **Graham**. Mr. Zwick, in your testimony on page 11 you state:

> It would be preferable, for example, to place the subsidy for housing finance directly on the mortgage financing instrument itself rather than indirectly on one type of institution that is expected to support the housing market.

Could you elaborate as to how you might see a mechanism for placing the national subsidy for housing directly on the instrument rather than through an institution?

Mr. **Zwick**. I don't have a specific proposal, but clearly if you look at the history, the thrift industry was created as a special purpose vehicle to support housing and that has been a tradition that has carried through over the years and, as I would read the intent of public policy, we want to continue supporting housing into the future.

So the question then is, do you do it through a special purpose industry or do you do it by making a subsidy for those people who provide the mortgage funds or the construction funds for housing?

Now the history it seems to me is very clear. It worked well when we had low and stable interest rates. But when we reached the period where we deregulated interest rates and we decided to run large budget deficits which forced interest rates higher, you had a violent swing of interest rates which made the specialized industry specifically vulnerable for that policy.

So it seems to me, without getting out into other very fundamental issues, unless the government is going to guarantee low and stable interest rates—5.5 percent, 30-year Treasuries or something for the next 20 years—I think it is very dangerous to try to support an important public policy issue, housing, through a specialized instrument.

Senator **Graham**. Thank you, Mr. Chairman.

Senator **Garn**. Senator Graham, since there's just a few of us here, if you have any more questions, go ahead until the chairman gets back.

Senator **Graham**. No more questions, Mr. Chairman.

Senator **Garn**. Senator Cranston.

Senator **Cranston**. The chairman though you might have some questions.

Senator **Garn**. Well, I'm not going back to Treasury. We will next week but not again today.

Mr. Zwick, you made a comment about something that has not been discussed at all in the hearings so far, and that is the issue of the changes in the accounting and the share draft insurance funds for credit unions. Will you explain why you feel that needs to be changed?

Mr. ZWICK. Well, to a large degree, they have built in some of the risks in their regulatory environment, including the ability to count their premiums as part of their capital. And all we are saying—I am not here to propose specific reforms within the credit union matter, but it is clear that you have some of the seeds of the same problems within the credit union industry that you have in the thrift industry and when we straighten out the thrift and the bank thing we ought to probably be bringing the credit unions under the system treatment.

Senator GARN. Well, the reason I ask the question—and I'm not here to take the side of credit unions. I'm upset with them because of, in some cases, their violent breaking of the common bond. Those who are still doing their traditional service with their common bond, I'm in favor of. We have some in Utah that all you have to do is breathe Utah air and you have a common bond. And they are competing very directly with banks and thrifts and I think they are going to get themselves into trouble on the tax issue, at least those who violently break that common bond and spread so directly to the general public.

But my question is as much about whether regulatory changes need to be made as it is about their share draft fund because what we're trying to do with the FDIC is to raise them to 1.25 percent. They are about .83 percent. The credit union fund is at 1.25 percent or a little bit above and they have an automatic feature in there that if they drop to 1 percent they immediately have to chip in their percentage to keep it at 1 percent. That seems to me, at least from what I know of it, to avoid the pitfalls that are in FSLIC because there's no choice about it. The point they make is that if they are required to be equal and pay 1/12 of 1 percent, that actually drops the fund, because although they don't pay an automatic 1/12 of 1 percent, if that fund drops to 1 percent, then they've got to put in whatever is necessary to keep it at one.

Now both FSLIC and FDIC would love to be at one right now and their goal is to be at 1.25 percent. So I'm trying to understand people who say we need to force them to pay premiums like the others.

Mr. ZWICK. I don't think I said to pay premiums like the others. I said that at this time the two issues really are the accounting treatment and how they calculate as part of their capital, and the other one that you raised is more fundamental—what business they are in.

Sitting in Miami today, I am on the street competing with Eastern Credit Union for cash management systems within the city.

Senator GARN. It may not be around very long.

Mr. ZWICK. I don't know what happens to Eastern Credit Union under the current circumstances, but that is a large complex financial institution.

Senator GARN. Do either one of you two have any comments on this issue?

Mr. MCKINNEY. On the credit union issue?

Senator GARN. Specifically on the share draft insurance fund and the administration's recommendations to charge them premiums.

Mr. McKinney. The only comment I would have is in the spirit of making everything eventually standard or equal, and I would say that the standard would be the desired ratio—currently it's 1.25 percent. If the banks are going there eventually, and FSLIC, and they then could set a target similar to that and if they're there then it shouldn't affect their premium expense.

Senator Garn. That's my question. I'm a little bit puzzled by the proposal because they are already where we are saying FDIC and FSLIC have to go. It's a little hard for me to understand if they're already at the goal and automatically have to keep it at at least 1 percent, I fail to understand why the administration is making the recommendation.

Mr. Chairman, I have no further questions at this time.

The Chairman. Thank you very much, Senator Garn.

Let me just ask a couple of questions. I asked a question to the witnesses yesterday that I'm trying to get a yes or no answer on, and that is, whether you think the bill as presented by the administration treats the banks fairly and treats the thrifts fairly. Let me just go right down the table, Mr. McKinney, do you feel that the bill is basically fair? Granted there are parts of it that might not be quite the way you like, but generally, as a whole, is the bill fair to the banks?

Mr. McKinney. Yes.

The Chairman. Is it fair to the thrifts?

Mr. McKinney. Yes. Basically and in general terms, yes, but I would hope it could be fine-tuned.

The Chairman. I understand. Mr. Osteen.

Mr. Osteen. Senator, you've heard our recommendations. You have our statement. It does incorporate it. The answer to your question is yes and yes.

Mr. Zwick. Same answer.

The Chairman. Let me ask you this, Mr. Osteen. I think we need to know more about thrift holding companies than we presently do. In fact, there's not much in the way of data that is available generally that we've been able to find. That's one thing I'm determined to correct.

I understand that the bank board does not keep many thrift holding company data series information. At least that's the answer we're getting. Let me just ask you a series of questions.

Does your organization as a whole collect data about thrift holding companies?

Mr. Osteen. Yes, sir.

The Chairman. What kind of data do you collect?

Mr. Osteen. The numbers, the locations, the assets, the net worth, all those types of things. Financial data primarily.

The Chairman. Do you publish any of that data?

Mr. Osteen. No, we have not, but we would be delighted to prepare some summary information for your committee and submit it.

The Chairman. I think it's very important. I think the whole question of thrift holding companies is a very relevant part of this story, especially just given the direction that events seem to be taking us.

I would also like to have you think about the question of what kind of data you think the Bank Board itself ought to collect so that we're not just relying on an industry association to do a data collection job. What should the Bank Board be doing in terms of collecting and presenting thrift holding company information? I would also like your thoughts as to what should be collected and assessed by the Bank Board and then any differentiations you have in your thinking in terms of what they in turn should feel free to publish and share in the public domain and what kind of information would it be appropriate for them to have and keep track of that would remain proprietary in a sense and not be given to the public.

So would you take a look at that and we'd like to follow up with you on that issue.

Mr. OSTEEN. We'd be delighted to.

The CHAIRMAN. Mr. McKinney, in his prepared testimony, Mr. Osteen, states that "There should be parity between thrifts and banks in capital standards, premiums and logos." Do you agree with him on that? He doesn't mean tomorrow morning, but do you agree with him on that? If not, why not?

Mr. OSTEEN. Senator, I think that was out of my testimony. I agree with that 100 percent. [Laughter.]

The CHAIRMAN. You're exactly right and I misstated it and I apologize.

Let me serve that one up to Mr. McKinney.

Mr. MCKINNEY. You did catch my attention when you mentioned the word "logo."

The CHAIRMAN. I thought I might.

Mr. MCKINNEY. I would agree with most of that with the exception of the logo idea at this particular time. I think the public is confused and that we have to do everything we can to keep the waters calm and the environment very calm. And I think that's being done currently and we should do anything that would perpetuate a very calm and orderly resolution of this rather than trying to do it all within one quarter from a visibility standpoint like logos or do away with name restrictions where they could use any name or we could use any name.

So most of that I do agree with. Standardization of the ratios I do agree with and examination procedures.

The CHAIRMAN. We could pursue that but let me move to something else here. The bill continues the moratorium against switching from FSLIC or the new SAIF system to FDIC coverage for 5 years. Is that about the right period of time would you say, Mr. Zwick?

Mr. ZWICK. I think that's much too long and you're going to perpetuate this difference between the industries during that period and then you are going to come back to the common logo. It seems to me you've got a big problem here and you ought to get on with fixing it sooner rather than later, and that moratorium is an implicit recognition that you haven't fixed it.

The CHAIRMAN. Well, if it shouldn't be 5 years, what should it be?

Mr. ZWICK. I would remove it in August when it runs off.

Mr. OSTEEN. Mr. Chairman, I would agree that 5 years is too long, but I would somehow tie that to the ability of the institution to meet FDIC standards and at least if we adopt common standards that they be able to pass those standards before entering the FDIC fund. But I think it should be tied to the ability of the institution to perform.

Mr. McKINNEY. I would agree with what they both said.

The CHAIRMAN. A couple of us have had a couple or three rounds here and Senator Graham came a little bit later. Did you have other questions, Senator Graham?

Senator GRAHAM. If I could just follow up on your last question, isn't the practical effect of that standard which is when an institution reaches FDIC standards it should have the right to shift to FDIC going to be that all of the strong thrift institutions as quickly as they can get into a position to do so are going to move over to FDIC?

Mr. OSTEEN. I think, Senator, what we see here is a federally guaranteed deposit base, whether it be a thrift or a bank. I think the sooner we recognize that there is a single central payor and eliminate all these differentials and the confusion in the public's mind, the better. And I think moving from SAIF to BIF to DIF and all that business I think if we adopt a common risk-based capital standard that it shouldn't make any difference.

Senator GRAHAM. But if the premise of my question is correct—that is that the FDIC is the more attractive alternative if you can qualify for both and therefore there will be a process of adverse selection and people who can will leave FSLIC or whatever its successor agency is called and go to FDIC, and since the rescue plan of the thrift is predicated on deposit growth of FSLIC or its successor institutions and therefore the premiums that can be paid to support this plan, doesn't allowing for voluntary unrestrained shifting to FDIC by qualified institutions effectively undermine the financing plan?

Mr. ZWICK. I guess I would go to your basic premise. It seems to me what you're saying is we are not going to fix the problem and therefore the new FSLIC will not be healthy and we'll be back three to 5 years to deal with that problem. Therefore, I worry about putting artificial crutches in there as a way to avoid fixing the problem once and for all.

Senator GRAHAM. But even if the problem is fixed, it costs more to go to one doctor than the other and FSLIC will have a higher premium for the foreseeable future than will FDIC. If the two funds were equivalent in every other way, just that difference alone would cause people to elect to go into FDIC, would it not?

Mr. ZWICK. I think as you stated it's correct. Now they have to give up certain powers to go into FDIC at this point. So it isn't that case as now stated.

Senator GRAHAM. Thank you.

The CHAIRMAN. Senator Sanford.

Senator SANFORD. Thank you, Mr. Chairman. I apologize for not being here at the beginning of the hearing, but I have three committee meetings this morning. I am very much interested in this issue, as you know. I am certainly interested in it from a national point of view but especially because of the pretty good condition of the North Carolina institutions. I'm especially concerned that we go about this in a constructive way and do not put too many of the healthy institutions out of business.

Let me ask Mr. Osteen a question, Mr. Chairman. I haven't heard a great deal of comment about the position of the regional home loan banks. Of course, ours would be the Atlanta Home Loan Bank. The structure of it, the position of it, the contribution of funds from that source to the solution of this problem. Would you comment on the implications of the changes that relate to that?

Mr. OSTEEN. We must express some concern about utilization of too much of the resource i.e. the net worth of the retained earnings of the Federal Home Loan Bank System. As you know, they provide the basis for the borrowing capacity in the entire system and that net worth is looked to by the marketplace as something that's absolutely necessary.

This bill, as I understand it, reduces the net worth of those institutions by approximately 15 percent. It also puts in a fixed amount of dividends that will come out of those institutions.

Our association in this testimony recommends that that fixed amount be eliminated totally and that a percentage of the profitability of those institutions only be diverted to the insurance fund.

We have a substitute recommendation. We think that there's a source of revenues for the fund that have not been introduced as yet and we feel that any loss that might come to the fund from eliminating or reducing that source could possibly be picked up by adding a small fee on brokered deposits. We think that those are insured funds. The beneficiaries of those are not local entities. Those are not community funds. That's a nationwide market administered by investment houses and we think that it's only proper that a fee be assessed on brokered deposits and those revenues be diverted instead of the revenues from the Federal Home Loan Bank System banks into the insurance fund.

Senator SANFORD. Do you think that brokered deposits ought to be continued or is it a bad enough practice to be eliminated?

Mr. OSTEEN. I think there should be a charge made for the privilege of selling and administering pools of brokered deposits. I think the economics of those things should be reduced somewhat, not eliminated. But that has to be combined with some pretty tight restrictions on excessive growth. I have heard the arguments that it should be eliminated and I've heard the horror stories about had we not had brokered deposits we wouldn't be looking at a half of this problem, but I think that's not the way we do things in this country and I think we need to add—there is economic benefit to investment houses for this privilege and this service and they are insured and fees should be assessed for that.

Senator SANFORD. There's a tremendous advantage to the investment houses in that they get the benefit of the deposit insurance.

Mr. OSTEEN. Yes, sir, and they pay no part of that insurance premium.

Senator SANFORD. I wanted to ask one more question about the regional banks but I'll come back to that. I wonder if the other two witnesses would care to comment on brokered deposits.

Mr. MCKINNEY. I would again agree with Mr. Osteen on his approach that there is a place for them in the marketplace and the discipline would be the capital-to-asset ratios that should be forthcoming and applied to financial institutions and that would then cause them to not go out and seek brokered deposits if they were beginning to violate those ratios.

On the other hand, I totally agree that some sort of a cost structure or fee structure should be applied to those brokered deposits.

Mr. ZWICK. Senator, I agree completely with my two colleagues and you've put your finger on I think a very important issue that ought to be addressed.

Senator SANFORD. Thank you very much. If I may go back just for a minute to Mr. Osteen, it's also suggested that the composition of the regional home loan bank boards be changed.

Mr. OSTEEN. I think that suggestion goes back to something Senator Garn talked about earlier about political influence. I think to the extent necessary that the composition of those boards should be changed, possibly more in line—I hesitate to say this, Senator Garn—with the Federal Reserve Bank System.

Senator GARN. That's all right. That's independent.

Senator SANFORD. What's so attractive in the Federal Reserve way of doing it?

Mr. OSTEEN. I think there's a high level of independence. That's the sole difference. There's less perception of possibly a cuddly relationship between the regulator and the industry.

Senator SANFORD. You mean by that independence from the influence of the industry?

Mr. OSTEEN. Right. The regulator should not be the regulated.

Senator SANFORD. Mr. Chairman, I think I will relinquish the rest of my time if I have any. Thank you very much.

The CHAIRMAN. Thank you, Senator Sanford.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Just in closing today, I've been talking in some generalities myself so I thought it might be interesting to put in the record that from 1986 to 1988 the Office of the Comptroller of the Currency lost 79 people. 71 or 72 of them, I don't know which, went to the Federal Home Loan Bank Board.

Almost all of the top management of the Home Loan Bank System's Office of Regulatory Affairs came from the OCC. The Executive Director of the Office of Regulatory Affairs of the Home Loan Bank System was the Assistant Chief National Bank examiner at the OCC. The Deputy Executive Director of the Office of Regulatory Affairs was the Deputy Comptroller for Policy and Planning at OCC. The Managing Director of the Office of Regulatory Affairs was the Deputy Comptroller for Special Surveillance at the OCC. The Director of Capital Markets was the Assistant Director for Bank Supervision and Regulation at OCC. The Director of Industry Analysis was the Director of Industry Analysis for the OCC.

Now I'm going to look into this more and find out. I'm going to substantiate my position with facts and obviously OCC is running the Federal Home Loan Bank System—at least all of their top people are, because we made some regulatory changes that Senator Riegle and I fought for so that the Bank Board could be improved. So I fail to understand how putting under Treasury—you guys have got to go back and reexamine your position, you really do.

Mr. **Osteen**. May I respond with just one statement. You can have the best 20 athletes in the world and without a playbook they're not going to win any ballgames.

Senator **Garn**. Well, you're absolutely correct, but you all continue—everybody, not just you——

The **Chairman**. It works both ways. You can have a great playbook and lousy players and you don't play much of a game with that either.

Senator **Garn**. The point that I will make one more time that we agree with is that you've got to have that changed playbook with good people. Putting it under Treasury doesn't guarantee that or necessarily detract from it, but I can't find what it adds. My point of putting this actual information in is that obviously there is something that works when we change that regulatory structure to attract good people over there and they leave OCC to do it and OCC is under Treasury and under apportionment and under pay caps.

Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Garn.

I'm going to put the remainder of my questions in the record and ask if you'll respond to them.

Senator Cranston.

Senator **Cranston**. I have no further questions.

The **Chairman**. Senator Sanford.

Senator **Sanford**. Nothing further, Mr. Chairman.

The **Chairman**. Gentlemen, thank you for your testimony today.

The committee stands in recess until tomorrow morning.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

PROBLEMS OF THE FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION [FSLIC]

PART III OF IV

FRIDAY, MARCH 10, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Cranston, Dixon, Shelby, Bryan, Garn, and Pressler.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

I want to welcome our witnesses today and others that are in attendance.

Today is our 14th day of hearings on the FSLIC savings and loan problem. Earlier this week we heard from representatives of the thrift, banking, and financial services industries.

Today, we will hear from representatives of the real estate, mortgage banking, and home building industries. We welcome as witnesses this morning Mr. Willard Gourley, Jr., of the Mortgage Bankers Association; Mr. Kent Colton of the National Association of Home Builders; and Jerome Blank of the National Association of Realtors.

The financial services industry is an increasingly integrated industry with home builders owning thrifts or otherwise affiliated with thrifts, and with thrifts controlling mortgage banking companies, and with mortgage banking companies controlling thrifts. Therefore, many participants in the mortgage banking and home building industries have a direct stake in the successful resolution of the current problems of the thrift industry and the manner in which thrift regulation is reformed.

The real estate industry has a similar interest. Thrifts, along with third parties, have undertaken investments in lending that have resulted in tremendous losses due to various factors, including regional economic problems, that have depressed the value of thrifts' real estate collateral and investments. Some investments and loans have been very poorly considered or even undertaken in violation of law or in disregard for safe and sound underwriting practices.

These have created very substantial risks of loss. Many cases have already experienced losses, but many more will have to be resolved in the future.

Today, a tremendous aggregate of real estate assets are now held by the FSLIC in one capacity or another. These assets need to be liquidated. The timing and manner of their liquidation will affect the magnitude of the ultimate loss that is realized by the Treasury and, therefore, the U.S. taxpayer.

In many other respects the manner in which the thrift industry is resolved will significantly affect the real estate industry and mortgage markets. We want to make certain that we give careful consideration to the foreseeable implications of enacting into law a bill that addresses these issues and which affects these industries and through these industries the American people in very important ways.

I want to say at the outset as I was reviewing your statements, all of which we will make a part of the record, I noticed they go beyond the issue that we are really here for today and that's the savings and loan problem and the FSLIC problem and the package that the administration has presented.

So, I'm going to ask you to stick to that focus so that we have time available on that subject. There will be other times and occasions when we can get into any unrelated issues that you may want to bring to the attention of this committee, but I clearly do not want to get a feel on those things today because that's really not our purpose.

So with that, let me yield to my colleagues for any opening comments they have. Senator Garn.

Senator GARN. Thank you, Mr. Chairman. After 14 days of hearings, I don't think I can add anything new to what has been said about the thrift crisis plan. So I will yield back to my other colleagues and get to the testimony as soon as possible.

The CHAIRMAN. Thank you very much.

Senator Cranston.

Senator CRANSTON. Thank you. I, too, will be restrained in making any opening remarks. I welcome you here. I'm pleased that your organizations are supporting the Cranston-D'Amato Fannie Mae restructuring bill—or the Freddie Mac restructuring bill. I also want to just mention to you that the housing bill that Senator D'Amato and I and others have been working on with the Rouse-Maxwell task force will be introduced very shortly. I know that your organizations have been supportive. I'm very certain you will support the version that we will put together, but we will, of course, be interested in your thoughts upon it and we urge you to do all you can to muster support for that measure which is very important to carrying on housing in our country, as I think maintaining a solvent and strong thrift industry is very important to maintaining housing in the country. So I hope that's one goal that we will keep in mind and be able to help achieve. We look forward to your testimony.

The CHAIRMAN. Thank you, Senator Cranston.

Senator Pressler.

Senator PRESSLER. Thank you, Mr. Chairman.

I do not have an opening statement, but I am looking forward to hearing some ideas on—I know that each of you have indicated that the administration is too stringent in requiring the S&L's to increase their capital to 6 percent by June 1, 1991 and what the alternatives to this are, especially for the smaller savings and loans, and what this whole package wouldn't come unraveled if that were the case is something I will be listening and reading very closely in your statements. And I have some questions which I will address later.

The CHAIRMAN. Very good. Thank you, Senator Pressler.

Senator Bryan.

Senator BRYAN. Thank you, Mr. Chairman. I have no opening statement.

The CHAIRMAN. Very good.

Let us now proceed in order to our witnesses this morning and I think we will hear first from Mr. Blank, who is the chairman of the Realtors Legislation Committee here in Washington, DC. Mr. Blank, let us hear from you first.

STATEMENT OF JEROME BLANK, CHAIRMAN, REALTORS LEGISLATIVE COMMITTEE, NATIONAL ASSOCIATION OF REALTORS, WASHINGTON, DC

Mr. BLANK. Mr. Chairman, members of the committee, my name is Jerome Blank and I am a realtor from Albany, CA and the 1989 chairman of the Realtors Legislative Committee of the National Association of Realtors.

On behalf of the more than 800,000 members of our association, I would like to thank you and the members of this committee for the opportunity to present our views on the administration's proposal.

Mr. Chairman, the National Association of Realtors supports the goals of this legislation. First, to raise enough capital to shore up the FSLIC. Second, to create a statutory structure to ensure that this financial debacle never happens again. Third, to ensure that a viable source of supply of mortgage funds for housing survives and flourishes.

I would like to emphasize that a healthy housing finance delivery system would be the result of the administration's proposal. We do not want a thrift industry to continue in name only. We cannot support those institutions which want to call themselves thrifts but whose activities go far beyond this traditional realm.

We strongly support those measures to strengthen the financial stability of the system, including the merger of the FSLIC with the FDIC, the implementation of risk-based capital requirements, and an enhanced qualified thrift lender test, and expanding membership in the Federal Home Loan Bank System to institutions which would qualify under the QTL test.

We do not believe, however, that the proposal goes far enough. We believe it should limit the activities of all State-chartered institutions, not just State-chartered thrifts, to those activities permissible for federally chartered institutions.

Looking at the current situation makes it quite obvious that institutions involvement in nontraditional activities such as real estate equity investment and brokerage services have indeed threatened the stability of the entire financial system and have increased taxpayer liability to countless and as yet unknown billions of dollars.

Next, the realtors support the creation of the Resolution Trust Corporation or the RTC, and the strengthened Federal oversight in its operations. It is critical, however, Mr. Chairman, that the RTC not become just another FADA. We cannot stress enough that the RTC success hinges on the active involvement of housing and real estate professionals who can provide expert advice on the marketing and sale of foreclosed properties.

In addition, we must state candidly that REO's must not be dumped in order to comply with the proposed statutory life span of the RTC.

We support the attempt to establish an industry-independent Federal Home Loan Bank System by moving the insurance function to the FDIC. However, we do have some serious concerns that the administration's proposal will result in the loss of an autonomous Federal Home Loan Bank System and its board.

Moreover, such a move raises the issue of what role the Treasury Department will play in the authorization of credit allocation within the bank system. We would recommend further review of this issue.

Finally, and in conclusion, we are also concerned about the future of Freddie Mac under this proposal. We would recommend that the Freddie Mac board be expanded to include public sector representatives from the housing and real estate industries.

Thank you very much, Mr. Chairman, and members of the committee. I would be happy to answer any questions that you may have at a later time.

The CHAIRMAN. Thank you very much. That's helpful testimony to us.

[The complete prepared statement of Jerome Blank follows:]

STATEMENT OF THE
NATIONAL ASSOCIATION OF REALTORS®
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
MARCH 10, 1988

INTRODUCTION

Mr. Chairman, Members of the Committee, my name is Jerome Blank. I am a REALTOR® from Albany, California and the 1989 Chairman of the Legislative Committee for the NATIONAL ASSOCIATION OF REALTORS®. On behalf of the more than 800,000 members of our Association, I want to thank you and the Members of this Committee for the opportunity to present our views on the Administration's proposal, entitled the "Financial Institutions Reform, Recovery and Enforcement Act of 1989," which was introduced by Senators Riegle and Garn as S. 413 on February 22, 1989.

Our testimony will focus on the Administration's plan and those provisions as they relate to the thrift industry and its historic and future role vis-a-vis the housing/real estate industry.

Mr. Chairman, the principal issue for this Committee is to balance three goals that are of equal importance: The first is to raise enough capital to shore up the Federal Savings and Loan Insurance Corporation (FSLIC) and to resolve the failing institutions caseload. The second is to create a statutory and regulatory structure to ensure that this financial debacle never happens again. The third is to ensure a viable source and supply of mortgage funds for housing and American homebuyers survives and flourishes.

The National Association of Realtors supports the attainment of all three of these goals.

We note at the outset that some have argued that the Administration's proposal is nothing more than a back door attempt to eliminate a specialized provider of mortgage credit. We believe it is counterproductive to engage in an intellectual exercise as to whether or not the Administration's plan signals the death of the thrift industry as a specialized provider of mortgage credit or even whether the continued maintenance of the thrift industry -- as we currently know it -- is necessary to promote the ready availability of low-cost home financing. The Administration, in its proposal, in its testimony before this Committee and in response to questions raised by our association, has

clearly indicated that the nation needs a healthy cadre of institutions that serve as a housing finance delivery system.

In this vein, our association's chief concern is whether we want a thrift industry, whose statutory purpose, indeed mandate, is to provide Americans with a ready source of mortgage funds, to continue in name only. Absolutely not. We have in the past and will continue to favor a thrift industry that is and will remain faithful to its charter edict to provide housing finance for American homebuyers. We cannot, however, support those institutions which want to call themselves thrifts but whose activities go beyond this traditional realm. They cannot continue to enjoy the favored statutory status accorded them without fulfilling their statutory responsibility to be a major provider of home mortgage credit.

STRENGTHENED REGULATORY FRAMEWORK

Merger of the Deposit Insurance Funds

The NATIONAL ASSOCIATION OF REALTORS® strongly supports those elements of the Administration's proposal which shore up the framework of this nation's financial system. Safety and soundness are the linchpin of our banking system around which all public confidence flows. And, to state the obvious, restoration and maintenance of public confidence is critical to the success of this endeavor. We believe the system is strengthened and public confidence is restored by the proposed administrative merger of the Federal Savings and Loan Insurance Corporation (FSLIC) with the Federal Deposit Insurance Corporation (FDIC) with subsequent regulatory oversight of the insurance operations held by the FDIC. We would also recommend that the merger be accompanied by Congress' reaffirmation that the full faith and credit of the U.S. Government backs deposits in federally insured depository institutions up to the prescribed statutory ceiling of $100,000.

Implementation of Risk-Based Capital Requirements

A second key to ensuring the continued safety and soundness of the thrift industry is to establish uniformly applicable capital standards that strengthen and ensure the availability of mortgage credit. A solid framework will not only encourage the development of an adequately capitalized thrift industry, but also reinforce market discipline as it relates to thrifts.

The NATIONAL ASSOCIATION OF REALTORS® believes the risk-based capital guidelines, currently under consideration by the Federal Home Loan Bank Board (FHLBB), serve as a foundation from which to design such a capital framework for thrifts while promoting home mortgage lending. The proposed regulations appropriately focus on risk and require thrift management to make prudent investment decisions with their own capital at risk. They will also help thrifts reinforce their traditional strong suit -- home mortgage lending -- by providing incentives for home mortgage origination and investment in mortgage-related securities.

We note that the Administration's proposal would require the Chairman of the FHLB System to implement capital standards by June 1, 1991, that are no less stringent than those for national banks. We applaud the sensibility of converting to a risk-based capital system requiring thrifts to meet capital adequacy standards analogous to those proposed for banks. We are concerned, however, that the Administration's proposed effective date may be too optimistic and that, when combined with the proposed concomitant increase in thrifts' insurance premiums, could place an almost impossible burden on the thrift industry. We believe a more tenable transition could be effected by adopting the transition period outlined in the FHLBB risk-based capital proposal (12 FR 51800, 1988) recommending that by January 1, 1993, all insured institutions must have capital equal to their fully phased-in capital requirement.

If the FHLBB proposal is adopted by the Chairman of the Federal Home Loan Bank System in the 90-day period required in the Administration's proposal, we believe serious attention must be paid to the consequences of assigning a 200 percent risk weighting to real estate-owned property (REO). The purpose of the guidelines is to ensure that savings institutions engaging in risky activity are supported by adequate capital. While we recognize the riskiness associated with REOs, their placement in a "super-risk weighted" category could force thrifts to dump these investments in an attempt to reduce the amount of capital they will be required to retain. In areas of the country that are already economically depressed, this action could have disastrous effects. Even regions currently enjoying an economic upturn, albeit at a slow and uneven pace, would also be dramatically impacted if thrifts precipitously reduced their REO holdings.

FDIC Oversight of Activities of State-Chartered Institutions: Expanded Powers

We applaud those provisions in the Administration's proposal which would authorize the FDIC to determine by regulation, after consultation with the FHLB System and state financial institution supervisors, that with regard to state-chartered SAIF members, a permitted activity under state law poses a serious threat to the SAIF. If the FDIC issued such a regulation, the FDIC could prohibit any state-chartered savings association from directly engaging in such activity if it is not a permissible activity for a Federal savings and loan association under the Home Owners' Loan Act of 1933.

Unfortunately, we believe the proposal does not go far enough in its limitations in two respects. First, the FDIC's authority to limit risky state-authorized activities only applies to state-chartered savings associations; it does not uniformly extend to state-chartered banks. We believe that it should because the risk to the deposit insurance funds by virtue of any financial institution's involvement in state-authorized activities generally has exceeded the risk associated with activities permitted at the Federal level.

Second, and more importantly, we believe the Administration's proposal does not go far enough in that it should limit the activities of state-chartered institutions -- whether they are insured under the BIF or the SAIF -- to those activities permissible for Federally chartered institutions. There exists one Federal insurance underwriter -- the U.S. Government. While there may be symmetry between the Federal- and state-chartered institutions in terms of the amount of premiums assessed and the extent of coverage provided, there is complete asymmetry in terms of the actuarial risk to the deposit insurance system posed by the varying level of permissible activities. One has only to look at the recent statistics regarding the S&L/FSLIC crisis to see the obvious: according to the Chairman of the Federal Home Loan Bank Board, in 1988, approximately the same number of Federal-chartered and state-chartered savings associations were closed by the Bank Board; however, the cost to the FSLIC to resolve the state-chartered institutions was twice as much as their Federal counterparts. While many factors contributed to the cost, state-chartered institutions' departure from their traditional mortgage finance activities into nontraditional -- and acknowledged riskier -- activities obviously played a major role in the ultimate cost to the FSLIC and now, to the American taxpayer.

Mr. Chairman, the NATIONAL ASSOCIATION OF REALTORS® opposes the authority of all financial depository institutions which benefit from federal deposit insurance, favorable tax treatment, and special access to credit (including their parents, subsidiaries, affiliates and divisions) to participate in real estate equity investment activities and real estate brokerage services, which are not directly related to their primary function. If history is any indication, the S&L debacle -- particularly with regard to the industry's forays into real estate activities -- has proven true on our association's claims: these activities have threatened the safety and financial stability of the institutions and the system and have increased the risk of taxpayer liability to countless unknown billions of dollars.

Stronger Qualified Thrift Lender (QTL) Test: FHLBank Membership

The NATIONAL ASSOCIATION OF REALTORS® supports those provisions in the Administration's proposal to strengthen the Qualified Thrift Lender (QTL) test. Currently, a savings and loan association will be considered to be a qualified thrift lender if at least 60 percent of its assets are invested in real estate-related loans and other qualifying investments. This test must be met on an average basis in three out of every four quarters and two out of every three years. State-chartered savings banks that were chartered before October 15, 1982, are given ten years to satisfy the QTL requirements. Furthermore, any institution that fails to maintain its status as a qualified thrift lender may not be requalified for a period of five years.

The Administration's proposal would change the provision regarding standards for maintaining QTL status as well as establish "penalties" for those savings institutions which fail to maintain their QTL status. Under the proposal, any savings institution which loses its QTL status must re-qualify within one year following the initial loss and, thereafter, remain qualified. If an institution cannot become requalified within the following one-year period, then it must, within three years of the date such status is lost, convert its charter to one or more bank charters.

We support the tightened QTL provisions because they would provide the necessary inducements -- a statutory "carrot and stick" if you will -- for thrifts to continue to maintain their primary role as providers of housing finance and to ensure the continued availability of mortgage credit. We would also recommend Committee consideration to increase the QTL percentage to the extent that it would reinforce the thrift industry's focus back to housing finance.

The NATIONAL ASSOCIATION OF REALTORS® would also support permitting any insured financial institution which attains QTL status membership in the new Federal Home Loan Bank System.

Currently, membership in the twelve regional Federal Home Loan Banks is limited to FSLIC-insured savings institutions which are required to purchase stock in their respective District Bank. FDIC-insured savings banks may, but are not required to, become members and purchase stock as well. The primary mission of the Federal Home Loan Banks is to provide a reliable source of credit, referred to as advances, which the member savings associations may use for any purpose consistent with the promotion of home financing. Consistent with this statutory objective and the national policy of promoting the ready availability of mortgage credit, we support the concept of expanding membership in the Federal Home Loan Bank System to those commercial banks which meet the requirements of the Qualified Thrift Lender test and permitting them access to a flexible low-cost source of wholesale funds with which to provide economical home financing. Opening up stock membership in the Bank System would have the additional salutary effect of providing another avenue for thrifts to raise much-needed capital.

Appraiser Regulation

On November 25, 1988, the Office of Management and Budget (OMB) issued Circular A-129 which requires all Federal agencies, by July 1, 1991, to identify transactions that will require a state certified appraiser. This circular, however, does not cover appraisals performed by the Federal financial regulatory agencies, in particular, the Federal Home Loan Bank Board.

Accordingly, the Association believes that the federal banking regulators should require the use of state certified appraisers for jobs of greater size or complexity, but require state licensed or registered appraisers for simple one to four single family appraisals by June 1, 1991. Furthermore, we would like the new examiners to review the underwriting procedures to make certain that such state regulated appraisers are used and that the appraisals are performed according to the standards set forth by the Appraisal Foundation Standard Board at a minimum.

THE RESOLUTION TRUST CORPORATION

The Administration's proposal would create the Resolution Trust Corporation (RTC) to manage and resolve all cases involving institutions placed in receivership or liquidating conservatorship in the three years following the enactment of the legislation, and to manage the assets of the Federal Asset Disposition Association (FADA), which itself will be liquidated within six months of enactment.

The REALTORS® support the provisions which accord the Federal Government a stronger oversight role regarding the operations of the RTC. We believe it is important, in fact imperative, that the RTC not become the successor-in-interest to or even a "mega-version" of FADA. While hindsight is always twenty-twenty, we are all too painfully aware of the problems that plagued the FADA: a "private" corporation wielding governmental power and applying political patronage standards in determining the limited club of real estate professionals to be awarded the contracts on the FSLIC's nonperforming assets. The U.S. Government cannot afford a repeat performance of FADA simply because the stakes are now greater than ever before: the U.S. Government -- through the RTC -- will become the largest landowner in the United States and will have to dispose of over $150 billion in real estate and related assets.

We believe the RTC can be an effective corporate tool in the orderly disposition of real estate-owned (REO). We believe, however, that this new organization can fully accomplish its goals regarding the disposition of REO only with the active involvement of housing and real estate professional practitioners who can provide expert advice on the marketing and sale of foreclosed properties. Proper disposition of REO requires a knowledge of regional and local markets as well as marketing expertise that will be essential to the success of the Resolution Trust Corporation.

The NATIONAL ASSOCIATION OF REALTORS® and its affiliates believe that REO disposition under the auspices of the RTC should be delegated to the most appropriate regional or local level to assure the realization of fair market value for foreclosed properties, which could result in savings to the Federal Government and assure a phased reduction of inventories without undue disruptions to or distortions of regional or local markets. We would urge the Committee to recognize, however, that this process may take longer than proposed three-year statutory life expectancy provided the RTC in the legislation and that REO properties should not be "dumped" in order to comply with the proposed statutory deadline. We would recommend that flexibility be built into the legislative timetable to accommodate anticipated as well as unexpected economic variables which inevitably will arise in the future.

FEDERAL HOME LOAN BANK SYSTEM: REGULATORY AND CREDIT ALLOCATION ROLES

The NATIONAL ASSOCIATION OF REALTORS® understands the premise underlying the Administration's proposal to create the Federal Home Loan Bank System (FHLBS) which, as the statutory successor to the Federal Home Loan Bank Board, will: (1) be headed by a single chairman; (2) be put under the oversight of the Department of the Treasury (in a structure that parallels the Comptroller of the Currency); (3) charter federal savings associations, and (4) be the federal regulator of federal and state-chartered thrifts, as well as savings and loan holding companies.

We support the attempt to establish an industry-independent Federal Home Loan Bank System. We recognize that the current structure cannot continue. As we have stated earlier, we fully support the safety and soundness function being transferred to the FDIC. We have serious concerns, however, that the loss of an independent Federal Home Loan Bank System and its Board will result from the Administration's proposal. As the Committee is aware, the current structure of the Federal Home Loan Bank Board and Bank System is not entirely analogous to that of the Comptroller of the Currency in that the Bank Board has the increased responsibility for coordinating the operations of the twelve district FHLBanks. The proposed arrangement would put the new Federal Home Loan Bank System -- including the district FHLBanks -- under the jurisdiction of the Treasury Department and raises the issue of what role the Treasury Department can or may play in the authorization of credit allocation within the bank system. We would recommend further review of this issue, particularly the potential for Treasury's domination of the credit allocation function.

Future of Freddie Mac

The Administration proposes restructuring Freddie Mac's current board with a three-member Board of Directors composed of the secretaries of Treasury and HUD, or their designees, together with the chair of the Federal Home Loan Bank system. Freddie Mac's board structure is overdue for modernization, but we do not believe the Administration's proposed structure is fully beneficial to the corporation, nor does it reflect the important role that Freddie Mac plays in the nation's housing delivery system.

The NATIONAL ASSOCIATION OF REALTORS® supports in principle the proposed Freddie Mac Board structure outlined in S. 493, sponsored jointly by Senators Cranston and D'Amato. This proposal would establish an 18-member board, identical in structure to the current Fannie Mae board. Under this structure, the President would appoint five members of the new board and shareholders would elect the remaining 13 members.

We believe this necessary change in the constitution of the Freddie Mac board would put Fannie Mae and Freddie Mac on a level playing field. Without this proposed board re-structure, there is the very real possibility Freddie Mac's ability to remain competitive in the secondary mortgage market will be retarded.

TAX PROPOSALS FOR REO PROPERTY

In commenting on the FSLIC crisis, the NATIONAL ASSOCIATION OF REALTORS® cannot fail to mention the fact that many of the tax changes enacted in the 1986 Tax Reform Act, including the passive loss limitation, the investment interest rules, etc., have been extremely detrimental to rental or investment real estate and have contributed to the sizable increase in defaults and foreclosures of those properties over the past few years. In addition, by excluding depreciable property from the benefits of the proposed capital gains exclusion, the Administration's proposal to restore the capital gains exclusion

will compound the problems for the FSLIC and troubled financial institutions in disposing of REO properties.

A modest proposal that would ameliorate the problems of FSLIC in disposing of their real estate inventory is one involving the at-risk rules and FSLIC or troubled financial institutions. Specifically, the NATIONAL ASSOCIATION OF REALTORS® supports a proposal to provide an exemption from the at-risk rules for REO property (property acquired upon default or foreclosure) acquired from a financial institution. A proposal similar to the NAR policy position was contained in the 1987 Senate version of the Technical Corrections bill, but that provision was ultimately dropped. Under present law, a financial institution which has acquired real estate upon default or foreclosure is treated as the seller upon subsequent disposition. Consequently, if the financial institution selling the property makes a loan to the purchaser, the purchaser will not be at risk with respect to any amount of the loan other than the downpayment. This will exacerbate the difficulty for financial institutions in disposing of REO property.

CONCLUSION

Mr. Chairman, the NATIONAL ASSOCIATION OF REALTORS® believes that S. 413 provides the legislative mechanisms to modernize, strengthen and maintain not only the thrift industry but also the entire financial services industry. We hope that our comments and recommended changes will prove helpful in the Committee's analysis and enactment of this very vital legislation, and we look forward to assisting you in the process.

The CHAIRMAN. Before you start, Mr. Colton, let me acknowledge that Senator Shelby has come in. Did you have an opening comment, Senator Shelby?

Senator SHELBY. Mr. Chairman, I have an opening statement I'd like to ask unanimous consent it be made part of the record.

The CHAIRMAN. Without objection, it will be. I also have statements from Senators Dixon and Sasser for the record.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee completes another week of its tightly scheduled hearings on the problems of the thrift industry. I look forward to hearing the testimony of Jerome Blank of the National Association of Realtors, Kent Colton of the National Association of Home Builders, and Willard Gourley of the Mortgage Bankers Association.

In resolving the thrift crisis, U.S. taxpayers are getting saddled with an extraordinary bill—and none of us are happy about it. There is only one, very ordinary reason why we have to pay this bill: We are protecting the deposits of ordinary Americans.

We are not bailing out the thrifts. I would not stand for that. We are not bailing out the damaged, leaking boats of the mismanaged and fraudulently managed thrifts. If they are not now under water and already drowned, they will be shortly after this legislation passes. We are not bailing out the stockholders of these leaky savings and loans; they have been, or very soon will be, wiped out. We are not bailing out the managers of floundering thrifts; they have been, or very soon will be, thrown out.

But, that leaves the depositors. They cannot and will not be left out. We are throwing life-preservers to ordinary depositors and helping them to shore. If we let depositors drown, they would drag under much of our economy.

We established floodgates after the Great Depression, A Federal deposit insurance system that would prevent our economy from getting washed away again. That Federal insurance is to make sure that ordinary depositors will be protected if a bank or thrift goes under.

Our economy has not gotten washed away in facing this thrift mass. We are going to fix the regulatory system the best way we know how. The Government will stand foursquare behind its obligations to depositors because we must. The cost is painfully high. But, thank goodness, our depositors are safe.

Thank you, Mr. Chairman.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, I am pleased that the committee will today hear from the housing industry on the FSLIC crisis. I guess you could say that the housing industry, particularly the homebuilders and the realtors, are the customers of the savings and loans.

They can give a different perspective than we've been receiving. And they can tell us about the chnages that have taken place in the mortgage market in the 50 years since savings and loans came into being.

We face a housing crisis in this country. Homeownership has declined 20 percent among 25–34 year olds in the decade of the 1980's. This is the first such decline in the modern era.

Indeed, homelessness today is partly a result of the difficulty that young persons have affording their first home. This first time buyer difficulty means that more people rent and that rental housing is more expensive. Those poor souls that can't afford to rent are often forced into the streets.

Mr. Chairman, we all know that the thrifts have played a major role in providing homeownership in this country. And we know that a continued strong system of housing finance is vital.

But there are questions today about thrifts' ability to continue to be the strong providers of housing finance that they were in the past. We keep hearing about securitization—about the miraculous secondary market.

And we know that an industry that borrows short and lends long does not thrive during interest rate cycles like we've experienced over the last 20 years. Indeed, right now, with Alan Greenspan at the wheel, it looks like we're headed for a serious interest rate spiral. That's not good news for either homebuyers or thrifts.

All these are issues we have to consider carefully. We're making an enormous taxpayer investment in the savings and loan industry. And we face a collossal crisis in housing.

We have to make sure we're spending the taxpayers money in the most cost effective way. Thank you Mr. Chairman.

The CHAIRMAN. Mr. Colton.

STATEMENT OF KENT W. COLTON, EXECUTIVE VICE PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. COLTON. Mr. Chairman and members of the committee, my name is Kent Colton and I'm the executive vice president and chief executive officer of the National Association of Home Builders. I am pleased to be here to represent our 155,000 member firms and the 8 million employees who work in those firms.

Mr. Chairman, NAHB applauds the committee's prompt consideration of the administration's plan to deal with our system of financial institutions, and especially thrift reform. We seek quick action both in the Senate and in the House.

Before going into the specific areas where we think the legislation should be improved and clarified, I would like to give the committee an overview of NAHB's perspective on thrift reform.

NAHB strongly supports the quick action taken by the Bush administration to affirm the Federal backing of insured savings deposits and to begin the process for reform. The administration's plan provides a valuable framework for comprehensive reform of the savings and loan system.

In addition, we want to stress to the committee that savings and loan associations have been the backbone of America's housing finance system for decades. NAHB feels that it is essential that any plan to reform the thrift system be structured so as to ensure the continued existence of a strong housing finance delivery system.

I must admit that when we first heard the administration's proposal for reform we had serious questions as to what the potential impact would be on the housing finance system. However, in clarifying the administration's position, Treasury Secretary Brady testified before this committee on February 22 that: "The administration's plan is designed explicitly to promote housing finance by revitalizing the S&L industry and the Federal Home Loan Bank System." We accept and agree with this premise.

With this in mind, we do feel that a number of important modifications should be made if the plan is going to truly achieve the administration's objective to "promote housing finance."

A delicate balance must be struck between essential safeguards against the recurrence of today's crisis—we agree that this must never happen again—and the ability of the housing finance system to function over time. There is no question that the industry and the Federal Home Loan Bank System must be on the front lines and bear significant costs in resolving the problem. At the same time, if too much of the burden is heaped upon healthy S&L's and the Federal Home Loan Bank System, it will be extremely difficult to attract private capital into the thrift industry. If that happens, both taxpayers and mortgage borrowers will absorb greater costs.

We therefore recommend changes to S. 413 in three broad categories.

First, changes to ensure the maintenance of a strong primary mortgage finance system; second, development of a plan for the effective management and disposition of insolvent thrifts and their real estate assets—something the chairman just mentioned—and third, reformulation of Freddie Mac's Board and ownership structure.

Regarding the first category—changes needed in order to achieve a strong housing finance system—we urge three important modifications.

First, the legislation should establish clear capital requirements and phase them in over an appropriate period while allowing for some regulatory flexibility.

Let me be clear. NAHB supports higher capital requirements for thrifts as a key to ensuring the long-term viability of this central component of the housing finance system. However, the language of the administration's proposal requires thrifts to meet capital requirements that are "not less stringent than those for national banks." We recognize the reason for this wording and we concur with the general intent, however, we are concerned that this legislative language could ultimately be more confusing than constructive. There is already a great deal of confusion with regard to risk-based capital standards. Each of the Federal banking agencies—the Federal Reserve, the OCC, the FDIC—has its own set of capital requirements for the banks that it regulates, and these requirements are subject to change. At the same time the Federal Home Loan Bank Board has recently proposed a very different set of risk-based capital rules. NAHB feels that the legislation should clarify the capital requirements for S&L's by adopting the so-called Basel agreement on risk-based capital. This would resolve any confusion now resulting from the ambiguity of the statutory language. NAHB believes that two principles—simplicity and parity across all types of depository institutions—will be essential to the successful implementation of risk-based capital rules.

NAHB also agrees with the objective of the bill to set a deadline by which thrifts must meet higher capital requirements. However, we are concerned that the deadline now set forth in the legislation—June 1991—is too unrealistic, and we urge the committee to consider extending the deadline to say 5 years from date of enactment with very clear benchmarks along the way.

Second, we feel the definition of a "qualified thrift lender" should be strengthened. Thrifts that have kept to traditional housing activities have generally been more healthy and successful than those that have strayed from their original purpose. According to Federal Home Loan Bank statistics, institutions holding over 75 percent of their assets in 1-4 family mortgages and mortgage-backed securities as of September 1988 had more than two times the GAAP net worth and three times the annualized earnings compared to the industry as a whole.

CEBA provides that those thrifts holding 60 percent of their investments in "housing related" assets meet the test of being a "Qualified Thrift Lender" for purposes of having access to the Federal Home Loan Banks' advances window. However, the definition of "housing related" assets has become loosely interpreted by subsequent regulation so that thrifts can meet the requirements with relatively little investment in home mortgages, mortgage securities, and interim financing for residential projects. NAHB would like to see S. 413 tighten up the current definition of "housing related" assets. This could be achieved by either raising the current 60 percent figure—say to 70 percent—or by narrowing the current regulatory definition of "housing related."

Third, given the problems of the past, we believe that it is appropriate to have Treasury oversight of the regulatory functions of the Federal Home Loan Bank System and to have the Chairman of the Federal Home Loan Bank System report to the Secretary of the Treasury. However, the integrity of the regulatory authority of the Chairman of the Federal Home Loan Bank System should be assured, and the financial strength and independence of the 12 Federal Home Loan Banks must be preserved.

The Office of the Chairman of the Bank System must maintain clear chartering, rule-making, capital-setting and enforcement authority for the financial institutions under its jurisdiction. And as a general principle, the FDIC should have no greater authority relative to the institutions regulated by the Federal Home Loan Bank System than it enjoys relative to the national banks regulated by the OCC.

NAHB also urges Congress to take steps to ensure that the financial strength of the 12 Federal Home Loan Banks is not weakened by the proposed commitment of current and future retained earnings to support the projected bonding activity to the point where it can no longer function effectively. Further, we strongly recommend that the credit function and advance mechanisms of the 12 district banks be independent of the regulatory function of the Chairman of the Federal Home Loan Bank System.

On asset disposition, NAHB feels strongly that the handling of S&L dispositions and the disposition of real estate assets under the proposed RTC is one of the most important aspects of this legislation. It is also an area that requires further refinement. The management of these assets will eventually determine whether this turns out to be a $100 billion or so problem for the Treasury or even up to $200 or $300 billion. We urge the Congress to include in the legislation a requirement that the RTC develop and submit a business plan to Congress within 3 months of enactment. The plan should be aimed at obtaining the highest values for the institutions and assets, while being sensitive to the condition of local and regional economies. We also recommend that the structure of the board of the RTC be modified and that Congress authorize the RTC to operate for at least 8 years, rather than the 5 years now provided in the legislation.

Regarding the future of Freddie Mac, NAHB strongly supports S. 493, the Federal Home Loan Mortgage Corporation restructuring legislation introduced last week by Senators Cranston and D'Amato. NAHB believes that the current board and ownership structures of Fannie Mae have proven to be extremely effective. It provides the model for a reorganized Freddie Mac.

Mr. Chairman, as I close, I would like to note that we have not tried in this testimony to set forth detailed legislative language for the changes which we are recommending. Our goal has been rather to talk about principles and ideas for your consideration. However, we do intend to focus on specific legislative language as the bill moves through Congress and we would like to work with the committee and with the staff in such an effort.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much. I appreciate the suggestions that you and your people have been developing and that you've made here. I think those are very useful ideas for us to consider.

[The complete prepared statement of Kent Colton follows:]

TESTIMONY OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

before the

THE SENATE BANKING COMMITTEE

on

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT

MARCH 10, 1989

Mr. Chairman and members of the Committee, I am Kent Colton, Executive Vice President and Chief Executive Officer of the National Association of Home Builders. I am pleased to be here this morning to represent NAHB's 155,000 member firms, and the eight million employees who work for these firms, in expressing the Association's views on S.413, the Financial Institutions Reform, Recovery and Enforcement Act of 1989.

NAHB applauds your prompt consideration of the Administration's sweeping proposals dealing with our savings and loan system, including the deposit insurance, regulatory and supervisory components of this system. Careful but prompt action is essential in order to assure the integrity of our financial system as well as the long-term viability of our system of housing finance.

Before I begin our more detailed recommendations regarding this proposal, I would like to step back for a minute to outline NAHB's perspective on the issues that are before the Senate Banking Committee today.

PERSPECTIVES ON THRIFT REFORM

At the outset, we want to stress that NAHB strongly supports the quick actions already taken by the Administration to affirm the federal backing of insured savings deposits, to take control of insolvent savings institutions, and to begin the process for reform. We also commend the Administration's steps to ensure that perpetrators of fraud and abuse are dealt with forcefully. Such criminal actions are deplorable and undermine public confidence in all of our financial institutions. We agree strongly that this kind of problem must never happen again.

We also want to make it clear that savings and loan associations have been the backbone of America's housing finance system for decades, and the future of these institutions is of vital importance to the housing industry as well as to homebuyers throughout this nation. Our system of thrift institutions was established over 50 years ago to provide a stable and low-cost supply of capital for the production and the purchase of decent housing for Americans. This industry has served America's housing needs in commendable fashion throughout most of its history, and the objectives of the founders of the system are still legitimate public policy goals. As you work to develop legislation to shore up the soundness of our financial system -- an objective we strongly support -- we also believe the cost and availability of housing credit should be one of your touchstones as you develop both short- and long-term solutions to the problems we face today.

NAHB believes that the Administration's legislative proposal provides the foundation for strengthening our general financial system as well as America's housing finance system. I must admit that when we first heard of the proposals for reform, we had serious questions as to their impact on the Nation's housing finance system. However, in clarifying the Administration's position, Treasury Secretary Brady testified on February 22 that: "The Administration's plan is designed explicitly to promote housing finance by revitalizing the S&L industry and the Federal Home Loan Bank System." We accept and agree with this premise.

With this in mind, we feel that S.413 provides a solid framework for reform. However, we also believe that a number of important modifications need to be made if the plan is going to truly achieve the Administration's objective to "promote housing finance." A delicate balance must be struck between essential safeguards against the recurrence of today's crisis, and the ability of the housing finance system to function over time. There is no question that the industry and the FHLBSystem must be on the front lines and bear significant costs in resolving the problem. At the same time, if too much of the burden is heaped upon healthy S&Ls and the FHLBSystem, it will be extremely difficult to attract private capital into a thrift industry that already has shouldered a considerable burden. As a result, both taxpayers and mortgage borrowers will absorb greater costs.

As we analyze the long-term impact of thrift system reform on housing, three questions must be addressed: (1) Who will provide money to develop the land and construct the housing America needs?; (2) Who will be the major investors in mortgages, both as securities and as whole loans?; and (3) In a nation already plagued with a crisis of housing affordability and homelessness, what will be the cost of housing finance?

Based on this general background, we would like to propose a number of enhancements or modifications to the Administration's plan that we believe will help achieve the objectives that have been set forth. These enhancements fall into three categories:

1. Changes necessary to ensure maintenance of a strong primary mortgage finance system;

2. Development of a plan by which insolvent thrifts and their real estate assets will be managed and disposed of so as to maximize returns to offset the costs of the plan while at the same time preventing disruption of local markets and local economies; and

3. Reformulating Freddie Mac's board and ownership structure to ensure its long-term competitive position in the secondary mortgage and capital markets.

NAHB stands ready to work with Congress and the Administration to ensure that these modifications and other enhancements are made so that our system of insured depository institutions can be revitalized while at the same time addressing the housing finance needs of this country.

CHANGES NEEDED IN THE LEGISLATION IN ORDER TO ACHIEVE A STRONG HOUSING FINANCE SYSTEM

For 50 years our national housing policy has promoted decent and affordable housing for all Americans and widespread homeownership opportunities. Thrift institutions have been a major tool for implementing the Nation's housing policy. As a result, the thrift industry is the largest single investor in mortgage assets, holding nearly 45% of all residential mortgages and mortgage-backed securities. Thrifts also hold about half of all outstanding residential land and construction loans. This role in the housing production process is an essential element of the thrift commitment to housing that must not be overlooked in discussions of the need for thrift institutions in the current housing finance system.

The majority of thrifts have been able to conduct their activities profitably. Of the almost 3,100 FSLIC-insured thrifts 2,179 were profitable as of the end of the third quarter of last year. Thrifts that have kept to traditional housing activities and investments generally have been the most successful and, for the most part, have operated with a solid capital base and with competent and honest management. According to FHLBB statistics, institutions holding over 75 percent of their assets in 1-4 family mortgages and mortgage-backed securities as of September 1988 had more than two times the GAAP net worth and three times the annualized earnings compared to the industry as a whole.

We believe that certain changes need to be made to the Administration's legislative proposal in order to strengthen the financial position of thrift institutions and to ensure that the thrift industry continues to provide housing credit at favorable costs to the producers and consumers of housing. These changes fall into three categories: (1) capital requirements; (2) the qualified thrift lender test; and (3) the integrity of the Federal Home Loan Bank System.

Establish Clear Capital Requirements and Phase Them in over an Appropriate Period Allowing for some Regulatory Flexibility

NAHB supports higher capital requirements for thrifts as a key to ensuring the long-term viability of this central component of the housing finance system. Capital standards have been lax and should be strengthened. Congress should realize, of course, in establishing capital requirements, that we are dealing not only with the issue of higher capital per se, but that these requirements will have an impact on how capital is allocated among competing uses in our country.

The risk-based capital concept of prescribing capital needs by weighting the risks of various types of assets is one that NAHB supports. Three years of effort by ten industrialized nations produced a risk-based capital system for banks, referred to as the Basel Agreement. The Basel Agreement recognizes that sound housing investment deserves priority in investment decisions. For example, investments in mortgage securities issued by government agencies have relatively low risks and are weighted between 0% and 20%, requiring only the same percentage of the basic capital amount. High-quality single-family mortgages are weighted at 50%, requiring only half the regular capital as some other types of assets.

NAHB believes that simplicity and parity across types of depository institutions are keys to the implementation of risk-based capital rules. The language of the Administration proposal requires thrifts to meet capital requirements that are "not less stringent than those for national banks." Although we recognize the reason for this wording and even concur with the general intent, we are concerned that the legislative requirement could ultimately be more confusing than constructive. There is already a great deal of confusion with regard to risk-based capital standards. Each of the federal banking agencies -- the Federal Reserve, the OCC and the FDIC -- has its own set of capital requirements for the banks that it regulates, and these requirements are subject to change. At the same time, the FHLBB has proposed a very different risk-based capital rule.

If we truly want to establish a strong capital base for thrifts and all financial institutions, then there should be simplicity and parity in the capital guidelines. We therefore feel that the Basel Agreement should be adopted as the foundation for capital guidelines for all federally insured depository institutions. Without such parity and simplicity, the thrift industry will not be able to attract the outside capital necessary for strengthening the surviving thrifts or for resolving issues related to insolvent institutions. Not only would a more onerous thrift capital requirement increase the costs of housing, it would also increase the costs to the taxpayer of resolving this crisis.

The process of transition to higher level of capital is also critical. High capital requirements are essential, but in order to achieve their success, the implementation of higher capital requirements should be achieved over a reasonable and workable period. The deadline of June 1991 set forth in the Administration's proposal is not realistic. NAHB believes that the key to effective implementation is the achievement of an annual rate of increase in the capital level of an institution. Furthermore, the regulator should have some flexibility to deal with compliance on a case-by-case basis. Also, we believe that a target rate of annual increase based on after-tax retained earnings would also be more equitable for institutions in smaller communities. This does not mean that we believe that the implementation of the capital rules should be drawn out for many years. Rather, we recommend a transition period of, say, 5 years (as compared with 2 years) with several interim benchmarks along the way to assure that progress is being made.

Retain and Refine the Definition of a "Qualified Thrift Lender"

If the Nation's taxpayers are going to provide significant resources to restore the health and credibility of the thrift industry, it is imperative that the public policy objective served by the thrift commitment to housing finance should be retained and

even reinforced. Moreover, ensuring that thrifts remain involved in traditional housing investments will also assure that the current crisis will not happen again. The healthy thrifts generally are the institutions that have invested in housing; as noted above, the higher a thrift's proportion of assets held in housing-related items, the higher its net worth and the better its return on assets.

The definition of "Qualified Thrift Lender" (QTL), as well as the advantages associated with compliance, provides the most practical means of ensuring that thrifts continue to carry out public policy objectives. NAHB believes that if this public policy is to be effective, then the current definition of QTL should be strengthened.

NAHB strongly supported the establishment of a QTL test as an integral part of the thrift charter rather than as part of the tax laws. The Competitive Banking Equality Act accomplished this in 1987 by requiring thrifts to maintain 60% of their tangible assets in eligible housing-related investments. We firmly believe, however, that the legislative parameters were overly broad, and allow the FHLBB a liberal interpretation of eligible assets for compliance purposes.

There are two options for strengthening the current test. First, the percentage of assets held in eligible housing-related investments could be increased from the current 60%. Second, the current percentage could remain unchanged, while the definition of eligible assets could be limited to those assets that clearly and directly contribute funds for housing, including land acquisition, development, construction and rehabilitation. Under this option, the definition should specifically exclude assets that do not directly provide funds for residential finance, such as deposits in other insured institutions or in the Federal Home Loan Banks; foreclosed properties; business premises and fixed assets; stocks and other non-mortgage obligations of the Federal Home Loan Banks, the Financing Corporation, Resolution Financing Corporation, FNMA, FHLMC, FSLIC or FDIC; mortgage servicing rights for mortgages not held in portfolio; and liquid assets.

NAHB would be pleased to work with the Committee to evaluate these options in an effort to determine the best means of ensuring that public policy is carried out in a way that will promote the soundness of the institutions, the ability of the institutions to achieve a profit, and the affordability of housing credits.

Maintain the Integrity of the FHLBSystem and the 12 Federal Home Loan Banks

NAHB agrees that changes are needed in the current regulatory process if a repetition of serious problems is to be prevented and public confidence is to be restored. Given the problems of the past, we believe that it is appropriate to have Treasury oversight of the regulatory functions of the Federal Home Loan Bank System and to have the Chairman of the FHLBS report to the Secretary of the Treasury. We should like to stress, however, that the integrity of the regulatory authority of the FHLBS Chairman over the FHLBSystem should be assured, and that the financial strength and independence of the 12 FHLBanks must be preserved.

First, the language of the Administration's proposal allows much of the rulemaking and supervisory authority over FSLIC-insured institutions to be vested in the FDIC. We feel that this situation is inconsistent with the concept of a primary regulator with principal rulemaking authority over the institutions it charters or to which it grants system membership.

In reorganizing the FHLBanks and its single chairman as an office of the Treasury, we recommend a regulatory structure for thrifts that parallels that of the Office of Comptroller of the Currency and its authorities as chartering agent and primary regulator of national banks. The Office of the Chairman of the FHLBSystem should maintain clear chartering, rulemaking and enforcement authority for federal institutions and clear rulemaking authority over the institutions under its jurisdiction; for example, authority to impose capital rules, within parameters set by this legislation, should lie with FHLBS rather than with FDIC.

As a general principle, FDIC should have no greater authority relative to the institutions regulated by FHLBS than it enjoys relative to national banks regulated by OCC. OCC is a model for the primary regulation and supervision of depository institutions. It works successfully and it should be used for the FHLBSystem.

Second, NAHB urges Congress to take steps to assure that the financial strength of the 12 FHLBanks is not weakened so much by the proposed commitment of current and future retained earnings to support the projected bonding activity that it can no longer function effectively. The resources of the District Banks have already been tapped to provide $2.2 billion -- with another $800 million committed -- to the FICO bonds issued as part of the 1987 recapitalization of FSLIC. Although the FHLBanks maintained their high credit rating following their multi-billion-dollar outlay for the FICO bonds, it is questionable that they can maintain their credit rating following an additional $2 billion drain on their capital plus a long-term commitment to turn over annual retained earnings. A reduction in the credit rating of the Banks' consolidated obligations would increase the costs of advances and liquidity loans to thrifts. In addition, the financial demands placed on the FHLBanks would reduce the dividends received by thrifts and devalue the FHLBank stock held in their portfolios.

We are especially concerned that the proposal calls for $300 million of the Banks' earnings each year without regard to total annual earnings. Moreover, there is no limit on the duration of Banks' liability to contribute their earnings to the Treasury. These factors can only make it more difficult for the Banks to issue their own obligations and to operate as a funding mechanism for the industry. The Administration's proposal should, at the very least, provide for annual evaluations of the Banks' financial positions and funding needs prior to determining the amount of earnings to be drawn for payments on Refcorp bonds. The bill should also set some limits on the duration of liability so as to provide some degree of certainty to investors in System obligations. Preferably, the legislation should phase out the Banks' commitment of retained earnings and allow them to return to normal operations within a reasonable period.

Third, NAHB believes that the legislation must protect and preserve the financial independence of the 12 District Banks in terms of their ability to borrow in the capital markets and to extend credit through the advances mechanism. The District Banks need to be able to make financial decisions based on what is best for them and their member thrifts without major interference by the Treasury Department. Ideally, the credit function of the District Banks should be independent of the regulatory function of the Chairman of the FHLBSystem. One suggestion for achieving this might be for the directors of the 12 Banks to have a joint financing mechanism that is not under the control of the Chairman. The current Office of Finance of the District Banks has been exceptionally successful and may provide the pattern for protecting the independent financial activities of the District Banks. Preserving the independence from Treasury of the credit functions of the FHLBanks will require important changes in the bill.

As a concluding comment to this portion of the testimony, I should note that we have not tried to set forth detailed legislative language for the changes we are recommending. Our goal here is to set forth principles and ideas for your consideration. However, we do intend to focus on specific legislative language as the bill moves through Congress and would like to work with the Committee and your staff in such an effort.

ASSET DISPOSITION

NAHB feels strongly that handling of S&L dispositions and the disposition of real estate assets under the proposed Resolution Trust Corporation (RTC) is one of the most important aspects of this legislation. However, it is an area that needs further refinement. The bill lays out the broad structure of the RTC but not its direction. The proposal does not specifically address the method of handling the disposition of the estimated 350-500 insolvent S&Ls, and their assets, that will ultimately be under the control of the RTC. We believe that such a plan is necessary since the Administration's proposal relies on the proceeds from asset disposition to generate funds to offset the costs of the proposed bond issues. If these assets are managed correctly, it could save the Treasury a great deal. If the effort is mismanaged, it will be very costly.

Given this reality, we are concerned about a "fire sale" approach to bring in quick revenue to reduce Treasury outlays up front, which would have an immediate adverse impact upon local real estate markets, particulary in the Southwest and other troubled markets. The reverse problem of simply sitting on assets is equally troubling. Holding real estate assets off the market in anticipation of further increase in real estate values can create an oppressive "overhang" of properties that distorts the valuation of properties on the market and increases uncertainties.

Although the RTC will attempt the resolution of whole institutions through acquisitions or assumptions, it must be prepared to deal with the assets of those institutions for which

liquidation is the only solution. The RTC needs a management plan with clear objectives both for purchase-and-assumption transactions and for asset management and disposition. We urge Congress to include in the legislation a requirement that the RTC develop and submit such a business plan to Congress within three months of enactment. The plan should be aimed at obtaining the highest values for the institutions and assets, while being sensitive to the condition of local and regional economies.

Well-managed, successful S&Ls in areas that are severely affected by the S&L crisis, such as Texas, Colorado and other energy states in the Southwest, have already suffered tremendously from sharp downturns in economic activity and from auctions and other examples of distress sales of real estate assets. Recovery of these markets requires a stabilizing approach combined with steady economic growth if we are to avoid further failures. The proposed 5-year life of the RTC may not be consistent with an asset management policy aimed at maximizing long-term returns. We believe that responsible disposition of real estate assets on this scale cannot be accomplished in less than 8 to 10 years to allow for real estate cycles. Thus, NAHB recommends that Congress authorize the RTC to operate for at least 8 years.

In addition, we are convinced that the Chairman of the FHLBS as well as the Comptroller of the Currency should be members of the governing board of the RTC and be integrally involved in the management decisions made with respect to the disposition of insolvent institutions and the effects on the broader economic and financial system.

THE FUTURE OF FREDDIE MAC

NAHB supports the Federal Home Loan Mortgage Corporation restructuring bill S.493, recently introduced by Senator Cranston and Senator D'Amato. We believe that the success of our Nation's housing policy has been largely aided by an efficient secondary mortgage market which was developed with limited, but important, government support. Fannie Mae and Freddie Mac, along with Ginnie Mae, have provided the innovation and standardization needed to meet the demand for low-cost credit for homeownership and rental housing through creation of a nation-wide secondary mortgage market. The proposed restructuring and revitalization of the S&L system, broadly defined, should be viewed as an opportunity to enhance the competitive position of Freddie Mac. NAHB believes that the current board and ownership structures of FNMA have proven extremely effective and provide not only the model for a reorganized FHLMC but also the key to FHLMC's future success. NAHB supports legislative action that would (1) make FHLMC independent of the FHLBSystem; (2) restructure its board of directors through expansion and inclusion of both publicly appointed and privately elected directors; and (3) restructure its ownership base using voting common stock that is publicly traded.

CONCLUDING REMARKS

NAHB views the Administration's legislative proposal as a valuable framework for comprehensive reform of the savings and loan system. In addition we have recommended a number of changes to this package. These changes are intended to preserve the strength of our financial system, to maintain the strength of both the primary and secondary housing finance systems, and to facilitate the management and disposition of insolvent thrift institutions and their real estate assets.

In closing, we would like to reiterate the perspective that lies behind our recommendations. We believe that the final legislation must strike a delicate balance. Clearly, Congress and the Administration must ensure that a situation similar to the current "thrift crisis" does not happen again. At the same time, you must seek the most cost-effective solution while keeping America's need for affordable housing clearly in focus.

In this regard, it is important that the solution maintains the value of the thrift charter and does not discourage the flow of private capital into the thrift industry. To do so would simply increase the cost to the taxpayer of dealing with the thrift crisis and increase the cost of residential mortgage credit for home buyers.

Finally, we would like to stress that specialization in housing finance has not been the source of the current "thrift problem." On the contrary, those institutions that have been heavily concentrated in mortgage loans and mortgage-backed securities have performed well. It is clearly possible to balance safety and soundness with a strong housing finance system.

The CHAIRMAN. Mr. Gourley, we'd love to hear from you now.

STATEMENT OF WILLARD GOURLEY, PRESIDENT, MORTGAGE BANKERS ASSOCIATION OF AMERICA, ACCOMPANIED BY BURTON WOOD, LEGISLATIVE COUNSEL; AND BRIAN COONEY, ASSOCIATE LEGISLATIVE COUNSEL

Mr. GOURLEY. Thank you. Mr. Chairman and members of the committee, my name is Willard Gourley and I am vice chairman of BarclaysAmerican/Mortgage of Charlotte, NC, and currently serve as president of the Mortgage Bankers Association of America. With me today I have Burton Wood, who is MBA's legislative counsel, and Brian Cooney, MBA's associate legislative counsel. MBA appreciates the opportunity to appear before you today to testify on the administration's proposal for resolving the crisis confronting FSLIC and the thrift industry.

The mortgage banking industry welcomes the willingness of the committee, and of the administration, to act to resolve these problems. The administration's plan deals quickly with insolvent institutions by placing them under joint FSLIC/FDIC supervisory control. Importantly, very importantly so far as we're concerned, it also restricts asset growth of unhealthy thrifts if they fail to meet the minimum standardized capital requirements or if they are taking excessive risks. This is a very important step so far as we are concerned.

With respect to the general issue of how to recapitalize FSLIC, MBA would strongly oppose any attempts to impose a fee or a tax specifically targeted to mortgage originations or to transfers of mortgage-backed securities, as some have suggested. The FSLIC crisis raises broad public policy issues and we believe any necessary taxpayer bailout should be broad-based, and not placed on the backs of future home owners or borrowers.

Regarding the administration's proposed restructuring of Freddie Mac's board—I got your instructions very clearly about not getting too far into the other items, but I would like to make this point very strongly. We believe it needs to be shareholder controlled and would oppose the administration's recommendation for a three-member board.

We strongly support S. 493, the bill cosponsored by Senators Cranston and D'Amato. The board created under this would parallel Fannie Mae's and we think that's a good structure and should likely be supervised by HUD.

Housing needs direction from the Cabinet level position that's concerned with the Nation's home owners, and not from the Treasury whose primary concern is raising revenue for the Government. Freddie Mac's congressionally mandated charter calls for it to make mortgage credit more readily available to the secondary market, and Treasury's control would potentially put it in conflict with this housing mandate. So we would just like to restate that.

Just to be sure that everyone understands, we believe that any board structure should include mortgage banking representation, but that's not our only real concern; it's that the board have broad industry representation, including home builders, thrifts, mortgage bankers, commercial bankers, and members of the real estate industry.

During 1986, the mortgage industry experienced an unprecedented upsurge in business, including new originations and refinancings, due to relatively low interest rates. In that year, approximately $266 billion in mortgage-backed securities were issued through the secondary mortgage market. By comparison, only $166.6 billion in mortgage-backed securities were issued during 1988. These 1986 figures in comparing the present level of business clearly demonstrates that the secondary mortgage market has the capacity to accommodate much more activity than its current levels.

In regard to this and the issue of the need for the thrift industry as a separate institution, during MBA's recent Board of Governors meeting in Washington, we passed a resolution that best expresses our concerns about the thrift industry and the availability of funds for the mortgage market.

This says:

> MBA believes that the well-developed secondary mortgage market has the capacity to meet the mortgage credit needs of American home buyers. Using the secondary mortgage market, the mortgage banking industry and depository institutions have in operation an assured and efficient means of providing home mortgage credit. While the secondary market has sufficient capacity to ensure adequate investment sources for residential mortgage credit, the need to maintain a mortgage credit delivery system that reaches to all geographic areas must be addressed in any reevaluation of the role that thrifts currently serve in providing primary mortgage credit.

It is clear that the urgency for action should not see that we throw the baby out with the bath water.

MBA appreciates the opportunity to appear before you today and we will be happy to answer any questions or provide any information we can.

The CHAIRMAN. Very good. Thank you. I appreciate your sensitivity to my request of staying on the subject of the S&L package.

[The complete prepared statement of Willard Gourley, Jr., follows:]

Summary of Willard Gourley, Jr.'s Statement
on behalf of the
Mortgage Bankers Association of America
Senate Banking Committee
March 10, 1989

GENERAL

The mortgage banking industry welcomes and applauds the Administration's willingness to act to resolve the crisis confronting the FSLIC and the thrift industry. The plan, embodied in S 413, is comprehensive in that it deals with all dimensions of the problem.

MBA is pleased that the plan deals quickly and efficiently with insolvent institutions by placing them under joint FSLIC/FDIC supervisory control. It also restricts asset growth of unhealthy thrifts if they fail to meet minimum standardized capital requirements, or if they are taking excessive risks.

MBA supports these changes because it means an opportunity for all mortgage lenders to do business on a more equal basis—without the destructive pricing and lending practices of crippled competitors. The plan, in good measure, meets the tests of preserving a sound, efficient market for mortgage lending.

With respect to the general issue of how to recapitalize FSLIC, MBA would strongly oppose any attempts to impose a fee or a tax, specifically targeted to mortgage originations or to transfers of mortgage-backed securities (MBSs). The FSLIC crisis raises broad public policy issues and we believe any necessary taxpayer bailout should be broad-based, and not focused on the obligations of future home borrowers.

FREDDIE MAC RESTRUCTURING

Treasury Department's Proposal

MBA strongly opposes the Administration's proposed restructuring of the Freddie Mac Board, as envisioned under S 413, for several reasons. Because its current Board, the FHLBB, is an independent agency, Freddie Mac has considerable autonomy to develop a variety of innovative mortgage products which today's mortgage marketplace demands. This variety benefits consumers, who enjoy a wider range of products from which to choose.

S 413, however, would take away Freddie Mac's autonomy by moving it under the Treasury Department, where two of the three proposed members of Freddie Mac's Board, the Chairman of the FHLBS, and the Treasury Secretary, would essentially be employees of the Treasury Department.

Placing Freddie Mac directly under Treasury's jurisdiction would create undesirable results, particularly for American homebuyers. These two entities would be working at cross-purposes, because Treasury's primary concern is raising revenue for the government, while Freddie Mac's Congressionally mandated charter calls upon it to make mortgage credit more readily available through the secondary market.

Because Treasury does not have the incentive to provide a variety of mortgage products, there would be less competition for Fannie Mae to offer attractive mortgage rates and a wide variety of mortgage programs. This could result in limited availability of mortgages, and could raise mortgage interest rates.

Benefits of S 493

MBA strongly supports S 493, the "Federal Home Loan Mortgage Corporation Transition Act" co-introduced by Senators Alan Cranston, and Alfonse D'Amato. This legislation would restructure Freddie Mac's Board so that it parallels that of Fannie Mae, its sister corporation and competitor in the secondary mortgage market, by providing for 5 Presidential appointees and 13 shareholder-elected directors. It seems logical to have similar board representation for secondary market agencies that provide similar services and that share similar missions regarding housing affordability.

With respect to the composition of Freddie Mac's Board, MBA believes the Board should include a representative of the mortgage banking industry. Mortgage bankers last year accounted for about 38 percent of all new mortgages acquired by Freddie Mac. Mortgage bankers also consistently originate the bulk of all Federal Housing Administration (FHA) and Veterans Administration (VA) loans made each year. These programs are designed to serve primarily moderate- and middle-income homebuyers. Representation of the mortgage banking industry on Freddie Mac's Board would ensure that the mortgage financing interests of these homebuyers will be properly represented by this secondary market agency.

MBA also believes Freddie Mac's Board should predominantly represent the interests of its shareholders. Since Freddie Mac's preferred stock became freely tradeable just 70 days ago, fifty percent of the outstanding shares have been purchased by the general public. We believe these shareholders deserve Board representation so that their interests are properly protected.

With respect to the regulation of Freddie Mac, MBA believes oversight authority should be assigned to HUD, as provided in S 493. As the Federal agency charged with the primary regulation and administration of our nation's Federal housing policy and programs, HUD is best equipped to ensure Freddie Mac's commitment in addressing the government's concerns regarding housing affordability, including the needs of moderate income renters.

CAPACITY OF THE SECONDARY MORTGAGE MARKET TO MEET MORTGAGE CREDIT DEMAND

If enacted, certain proposals found in S 413, including standardized capital requirements, and the allowance of bank holding companies to acquire healthy thrifts, would result in the consolidation of the mortgage lending industry. Some might ask how the secondary market would respond to the possible restructuring and consolidation of traditional portfolio lenders.

Regardless of the extent of such restructuring, MBA believes the well-developed secondary mortgage market has the capacity to meet the mortgage credit needs of American homebuyers. During 1986, the mortgage industry experienced an unprecedented upsurge in business (including new originations and refinancings) due to relatively low interest rates. In that year, approximately $266 billion in MBSs were issued through the secondary mortgage market. By comparison, $166.6 billion in MBSs were issued during 1988, representing a 38 percent decrease from 1986. These figures demonstrate that the secondary mortgage market has the capacity to accommodate much more activity than at current levels.

While the secondary market has sufficient capacity to ensure adequate investment sources for residential mortgage credit, the need to maintain a mortgage credit delivery system that reaches to all geographic areas must be addressed in any re-evaluation of the role that thrifts currently serve in providing primary mortgage credit.

UNSOUND LENDING PRACTICES

Irresponsible Pricing by Insolvent Institutions

S 413 contains a provision that would provide the FDIC and the FHLBS with the authority to limit or prohibit the growth of thrift institutions that do not meet minimum capital standards, or that are taking excessive risks. MBA strongly supports this provision, which is consistent with our policy position that the FHLBB should: (1) prevent FHLBB-designated insolvent thrifts from originating new business, and (2) implement a policy that an insolvent thrift's cash inflow be used only for maintaining minimum liquidity, restructuring existing assets, or reducing its liabilities.

MBA's policy position arose out of concerns relating to the adjustable rate mortgage (ARM) pricing practices of certain insolvent thrifts. Below-market ARM pricing is apparently pursued most often by insolvent thrifts that "have nothing to lose" because they are FSLIC insured.

Consumers, including mortgage borrowers and depositors alike, are ultimately harmed as a result of imprudent thrift pricing practices. Borrowers who are qualified for deep discount ARMs at the first-year rate have a greater likelihood of suffering severe payment shock in future years than their counterparts who are qualified at more realistic rates. Because the dramatic increase in monthly payments is more than many borrowers can handle, they are faced with foreclosure and a possible loss of the equity in their homes.

Low Documentation Loans

During the past year, there has been a proliferation of low documentation loans, whereby lenders underwrite mortgage loans without checking the current assets or income of loan applicants. MBA believes the use of this type of alternative documentation to streamline the mortgage origination process is justified where sufficiently large downpayments are made.

However, there has been an increasing incidence of low documentation loans with LTV ratios above 80 percent, and they are now approaching 90 percent LTVs. MBA is deeply concerned about the actuarial risks associated with these programs and the excessive risks they pose to the FDIC and FSLIC funds.

MBA believes that actions must be taken to reduce the risks associated with low documentation loans, and will work with the supervisory agencies to review these programs.

Mr. Chairman and Members of the Committee, I am Willard Gourley, Jr., Vice Chairman of BarclaysAmerican/Mortgage Corporation, located in Charlotte, North Carolina. I also serve as the current President of the Mortgage Bankers Association of America (MBA).* Accompanying me today are Burton C. Wood, MBA's Legislative Counsel, and Brian D. Cooney, MBA's Associate Legislative Counsel.

MBA appreciates the opportunity to appear before you today to testify with respect to S 413, the "Financial Institutions Reform, Recovery, and Enforcement Act," co-introduced on February 22, 1989, by Senators Donald W. Riegle, Chairman, and Jake Garn, Ranking Minority Member, of this Committee. This legislation was introduced at the request of the Treasury Department. We also appreciate the opportunity to testify with respect to S 493, the "Federal Home Loan Mortgage Corporation Transition Act," which we strongly support, co-introduced on March 2, 1989, by Senators Alan Cranston, Chairman, and Alfonse D'Amato, Ranking Minority Member, of the Subcommittee on Housing and Urban Affairs.

Below is a general discussion of MBA's views regarding the Administration's plan for the thrift crisis, followed by our comments relating to specific issues affecting the mortgage banking industry.

GENERAL

Background

The mortgage banking industry welcomes and applauds the Administration's willingness to act to resolve the crisis confronting the Federal Savings and Loan Insurance Corporation (FSLIC) and the thrift industry. The plan, embodied in S 413, is comprehensive in that it deals with all dimensions of the problem. It provides, in part, for:

— Recapitalization of FSLIC through the sale of $50 billion in bonds.

— Increased insurance premiums for institutions insured by FSLIC and the Federal Deposit Insurance Corporation (FDIC).

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

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-- Maintenance of separate insurance funds for the FSLIC and the FDIC.

-- Immediate joint supervisory control over insolvent institutions by the FSLIC and the FDIC.

-- Enhanced enforcement authorities and penalties to be used by Federal regulators and prosecutors.

S 413 represents a courageous step toward resolving the situation.

Basic Economics of S 413

Although there are understandable doubts about the eventual cost of the plan, these uncertainties do not alter the fundamental soundness of its approach. The $50 billion outlay over a three year period will permit the Federal government to fulfill its obligations to thrift depositors, while closing or merging insolvent institutions into healthy ones.

The most serious concern about the plan is that it adds near-term government outlays, without reflecting those outlays in the Federal budget. Whether or not these outlays are counted on- or off-budget, it is likely that the cost of the thrift rescue plan has already been anticipated by the marketplace and has been incorporated into current interest rates. Therefore, the ability of thrifts, banks, and other lenders to provide credit to private borrowers would be undiminished by the newly issued government bonds.

With respect to the general issue of how to recapitalize FSLIC, MBA would strongly oppose any attempts to impose a fee or a tax, specifically targeted to mortgage originations or to MBS transfers. The FSLIC crisis raises broad public policy issues and we believe any necessary taxpayer bailout should be broad-based, and not focused on the obligations of future home borrowers.

Implications of the Plan for Housing Finance and Interest Rates

The recapitalization of FSLIC should have no real impact on the overall supply of available mortgage credit. Because money is fungible and capital markets are efficient, credit flows will continue to move smoothly into the housing market as long as returns to investors are competitive with other credit market returns.

The secondary mortgage market plays a unique role in channelling investors' dollars into the housing market. It does this by providing liquidity for mortgage investments, thereby improving the distribution of investment capital available for home mortgage financing.

The size and sophistication of the secondary mortgage market have increased dramatically in recent years. In 1986 and 1987, mortgage-backed securities (MBSs) issued by private issuers and the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae), and the Government National Mortgage Association (Ginnie Mae), accounted for over half of net acquisitions of loans (defined as originations plus purchases minus sales).

The growth of the secondary mortgage market has also resulted in significant shifts in the proportions of outstanding home mortgage debt held by various sectors. In 1973, savings institutions, including thrifts and credit unions, held nearly 60 percent of all outstanding mortgage debt, while secondary market investors held about 4 percent. By 1987, the proportion of outstanding mortgage debt held by savings institutions declined to 33 percent, while the proportion held by secondary marked investors increased to 35 percent.

By the end of 1987, over one-third of all outstanding mortgage debt had been securitized through the secondary market. (Note: These statistics, as well as all others found in this statement, have been furnished by MBA's Economics Department).

Due to the growth of the secondary market, the identity of the intermediary providing mortgage credit does not have an impact upon mortgage rates because rates are set in the credit markets. By way of analogy, it makes no difference from which securities broker an individual buys a Treasury bond, simply because the underlying price is set by the bond market, not by the broker. The same holds true for mortgage interest rates, regardless of which institution is originating the loans.

Restructuring the Thrift Industry

S 413 provides a comprehensive framework for dealing with the roots of the current crisis. It deals quickly and efficiently with insolvent institutions by placing them under joint FSLIC/FDIC supervisory control. It also restricts asset growth of unhealthy thrifts if they fail to meet minimum capital standards, or if they are taking excessive risks.

S 413 would separate FSLIC from the Federal Home Loan Bank Board (FHLBB). It would also standardize capital requirements, investment quality criteria, and financial and management performance standards for thrifts and commercial banks.

MBA supports all of these changes because it means an opportunity to do business on a more equal basis—without the destructive pricing and lending practices of crippled competitors. The plan, in good measure, meets the tests of preserving a sound, efficient market for mortgage lending.

FREDDIE MAC'S RESTRUCTURING

Background

Freddie Mac was created by Congress in 1970 for the purpose of offering supplementary assistance to the secondary mortgage market. It does this by providing a degree of liquidity for mortgage investments, thereby improving the distribution of investment capital for home mortgage financing. Freddie Mac has carried out its mission in an outstanding manner, and together with Fannie Mae, its sister corporation in the secondary market, provides mortgage capital, at reasonable rates, for American homebuyers. Since its inception, through December 31, 1988, Freddie Mac has purchased approximately $369 billion in mortgages, and has issued nearly $350 billion in MBSs, which has helped provide homes for about 7.3 million homeowners, and apartments for over 500,000 renters.

Currently, the three members of the FHLBB serve as Freddie Mac's Board of Directors. Its nonvoting common stock, 100,000 shares of which are issued and outstanding, are held by the 12 Federal Home Loan Banks (FHLBs) and are not permitted to be traded.

Freddie Mac's senior participating preferred stock (preferred stock), which is nonvoting, was initially issued on December 7, 1984, to member savings institutions of the 12 FHLBs, at no cost to those institutions. Two significant ownership restrictions were placed on the trading of the preferred stock by the FHLBB. First, only member institutions of the FHLB system could own the stock. Second, each institution's investment in Freddie Mac's preferred stock could not exceed one percent of the total number of shares outstanding.

Because these restrictions artificially suppressed the liquidity and market value of the preferred stock, last summer, Senator Alfonse D'Amato introduced S 2467, a bill to remove these restrictions. MBA testified in support of this legislation at a hearing on June 23, 1988. As a result of Congressional and industry support, on July 13, 1988, the FHLBB, by administrative order, removed the transferability restriction and increased the maximum number of shares that can be owned by a single holder. These changes became effective on January 1, 1989.

Today, the preferred stock is traded on the New York Stock Exchange and on the Pacific Stock Exchange. As of February 10, 1989, approximately 59 million shares were issued and outstanding, and were held by approximately 1900 shareholders, including thrifts, mortgage bankers, other institutional investors, and the general public.

Treasury Department's Proposal

The Administration would place the FHLBB directly under the jurisdiction of the Treasury Department, and rename it the Federal Home Loan Bank System (FHLBS). The board of the FHLBS would consist solely of the office of the Chairman. In place of the current Freddie Mac Board, S 413 provides for a new three member Board to consist of the Chairman of the FHLBS, the Secretary of the Treasury, or his designee, and the Secretary of Housing and Urban Development (HUD), or his designee.

MBA strongly opposes the Administration's proposed restructuring of the Freddie Mac Board, as envisioned under S 413, for several reasons. Because its current Board, the FHLBB, is an independent agency, Freddie Mac has considerable autonomy to develop a variety of innovative mortgage products which today's mortgage marketplace demands. This variety benefits consumers, who enjoy a wider range of products from which to choose.

S 413, however, would take away Freddie Mac's autonomy by moving it under the Treasury Department, where two of the three proposed members of Freddie Mac's Board, the Chairman of the FHLBS, and the Treasury Secretary, are essentially employees of the Treasury Department. This would place Freddie Mac under direct Federal control for the first time since its creation by Congress in 1970.

Placing Freddie Mac directly under Treasury's jurisdiction would create undesirable results, particularly for American homebuyers. Treasury's mission and expertise lie not in housing but in the areas of raising revenues through taxes and the sale of Treasury securities. These two entities would be working at cross-purposes, because Treasury's primary concern is raising revenue for the government, while Freddie Mac's Congressionally mandated charter calls upon it to make mortgage credit more readily available through the secondary market. In effect, placing Freddie Mac under Treasury would violate Congress' legislative intent that Freddie Mac provide liquidity for mortgage investments and improve the distribution of investment capital for home mortgage financing.

Because Treasury does not have the incentive to provide a variety of mortgage products, there would be less competition for Fannie Mae to offer attractive mortgage rates and a wide variety of mortgage programs. This could result in limited availability of mortgages, and could raise mortgage interest rates.

Moreover, if past is prologue, the Treasury, in its effort to reduce the Federal budget deficit, may look to Freddie Mac's revenues, or may impose user fees (taxes) on its MBS issuances, further reducing Freddie Mac's effectiveness in providing available mortgage credit.

Benefits of S 493

MBA strongly supports S 493, which would restructure Freddie Mac's Board so that it parallels that of Fannie Mae, its sister corporation and competitor in the secondary mortgage market. S 493 would also subject Freddie Mac to the same regulatory and standby credit authority as Fannie Mae.

S 493 provides, in essence, that:

- The Board shall consist of 18 persons, five of whom shall be appointed annually by the President, and the remainder shall be elected annually by voting common stockholders. The five Presidential appointees shall include at least one person from each of the homebuilding, mortgage lending, and real estate industries.
- An interim Board of Directors shall serve until the first meeting of the voting common stockholders. The interim Board shall consist of the President of Freddie Mac, the Chairman of the FHLBS, and the Secretary of HUD.
- The common stock of Freddie Mac shall consist of nonvoting common stock, issued to the 12 FHLBs, and voting common stock, which shall be swapped in exchange for preferred stock held on the date of enactment of the legislation. Such voting common stock shall retain all of the rights, priorities, and privileges of the preferred stock.
- The Secretary of HUD shall have general regulatory authority over Freddie Mac.
- The Secretary of the Treasury shall provide a line of credit to Freddie Mac up to $2.25 billion. (This is intended to replace Freddie Mac's current borrowing authority with the FHLBs, which is consistent with the Treasury Department's plan to sever the thrift industry's ties from its current regulator.)

With respect to the composition of Freddie Mac's Board, MBA believes the Board should include a representative of the mortgage banking industry. Mortgage bankers last year accounted for about 38 percent of all new mortgages acquired by Freddie Mac. Mortgage bankers also consistently originate the bulk of all Federal Housing Administration (FHA) and Veterans Administration (VA) loans made each year. These programs are designed to serve primarily moderate- and middle-income homebuyers. During the first three quarters of 1988 (the most recent data available), mortgage bankers originated approximately 71.6 percent of all FHA loans made, with an average loan amount of about $61,000. During that same period, mortgage bankers originated approximately 70.1 percent of all VA loans made, with an average loan amount of about $74,000.

Representation of the mortgage banking industry on Freddie Mac's Board would ensure that the mortgage financing interests of moderate- and middle-income homebuyers will be properly represented by this secondary market agency.

MBA also believes Freddie Mac's Board should predominantly represent the interests of its shareholders. Since Freddie Mac's preferred stock became freely tradeable just 70 days ago, fifty percent of the outstanding shares have been purchased by the general public. We believe these shareholders deserve Board representation so that their interests are properly protected.

The 18-member Board structure proposed in S 493 would be identical to the structure of Fannie Mae's board, whose Congressional charter also requires 5 Presidential appointees and 13 stockholder-elected directors. It seems logical to have similar board representation for secondary market agencies that provide similar services and that share similar missions regarding housing affordability.

With respect to the regulation of Freddie Mac, MBA believes oversight authority should be assigned to HUD, as provided in S 493. As the Federal agency charged with the primary regulation and administration of our nation's Federal housing policy and programs, HUD is best equipped to ensure Freddie Mac's commitment in addressing the government's concerns regarding affordable housing, including the needs of moderate income renters.

By way of analogy, HUD's general oversight of Fannie Mae has worked in ensuring that organization's commitment to affordable housing. Under HUD's jurisdiction, Fannie Mae has enhanced the efficient flow of funds to America's moderate-and middle-income housing markets. This goal is shared by Freddie Mac.

CAPACITY OF THE SECONDARY MORTGAGE MARKET TO MEET MORTGAGE CREDIT DEMAND

If enacted, certain proposals found in S 413, including standardized capital requirements, and the allowance of bank holding companies to acquire healthy thrifts, would result in the consolidation of the mortgage lending industry through mergers, acquisitions, or a discontinuance of operations by certain institutions, either voluntarily or involuntarily. Some might ask how the secondary market would respond to the possible restructuring and consolidation of traditional portfolio lenders.

Regardless of the extent of such restructuring, MBA believes the well-developed secondary mortgage market has the capacity to meet the mortgage credit needs of American homebuyers. During 1986, the mortgage industry experienced an unprecedented upsurge in business (including new originations and refinancings) due to relatively low interest rates. In that year, approximately $266 billion in MBSs were issued through the secondary mortgage market. By comparison, $166.6 billion in MBSs were issued during 1988, representing a 38 percent decrease from 1986. These figures demonstrate that the secondary mortgage market has the capacity to accommodate much more activity than at current levels.

Mortgage companies, through the secondary market, also provide an efficient and stable source of mortgage funds during the good times, as well as the bad. During both the peak volume year of 1986, and then during 1988, when volume dropped significantly, mortgage companies originated between 25 and 30 percent of all loans made during those years.

While the secondary market has sufficient capacity to ensure adequate investment sources for residential mortgage credit, the need to maintain a mortgage credit delivery system that reaches to all geographic areas must be addressed in any re-evaluation of the role that thrifts currently serve in providing primary mortgage credit. Today, many regions of our country, particularly those rural in nature, are served only by local commercial banks or savings and loan associations. Therefore, it is important to be mindful of the potential impact proposals that restructuring might have on these institutions and their customers.

The role of thrifts in providing short-term construction financing should also be recognized, especially because other types of lenders, and the secondary market, are not equipped to provide all of these short-term funds.

UNSOUND LENDING PRACTICES

Irresponsible Pricing by Insolvent Institutions

S 413 contains a provision that would provide the FDIC and the FHLBS with the authority to limit or prohibit the growth of thrift institutions that do not meet minimum capital standards, or that are taking excessive risks. MBA strongly supports this provision, which is consistent with our policy position that the FHLBB should: (1) prevent FHLBB-designated insolvent thrifts from originating new business, and (2) implement a policy that an insolvent thrift's cash inflow be used only for maintaining minimum liquidity, restructuring existing assets, or reducing its liabilities.

MBA's policy position arose out of concerns relating to the adjustable rate mortgage (ARM) pricing practices of certain insolvent thrifts. Below-market ARM pricing is apparently pursued most often by insolvent thrifts that "have nothing to lose" because they are FSLIC-insured. These practices take business away from, and undermine the ability of sound lending institutions to stay in business.

Realizing the perils of offering deep discount loans, healthy mortgage lending firms offer ARM prices based on the realities of the lending marketplace. The prime source of mortgage banker funds for making home loans is the private secondary market. This includes investors such as pension and insurance funds, banks, even many thrifts, who buy both whole loans and MBSs at full market yields. It also includes Fannie Mae and Freddie Mac, who must pay full market rates as their cost of funds, and who must pay their shareholders a market rate of return.

Mortgage banking companies sell all loan production into the secondary mortgage market. Thus, they must originate loans that strictly conform to investor requirements. Because, for instance, Fannie Mae and Freddie Mac are unwilling to accept the low yields associated with deep discount ARMs, their pricing practices prevent the purchase of those loans. Also, recognizing the payment shock to home borrowers associated with ARMs, these secondary market agencies require borrowers to qualify at the fully indexed, second-year rate for any ARMs they do purchase.

Unhealthy thrift institutions, on the other hand, may qualify home borrowers at the deep discount, first-year rate. Because few secondary mortgage market investors are willing to purchase these loans, thrifts retain them in portfolio, hoping each successive year to realize the maximum, fully indexed rate for that year, or in the alternative, hoping rates come down so these loans become marketable.

Consumers, including mortgage borrowers and depositors alike, are ultimately harmed as a result of imprudent thrift pricing practices. Borrowers who are qualified for deep discount ARMs at the first-year rate have a greater likelihood of suffering severe payment shock in future years than their counterparts who are qualified at more realistic rates. Because the dramatic increase in monthly payments is more than many borrowers can handle, they are faced with foreclosure and a possible loss of the equity in their homes. The availability of deep discount ARMs also artificially fuels home price appreciation--their low initial rates allow borrowers to buy more house and allow sellers to demand higher prices, exacerbating affordability.

Low Documentation Loans

During the past year, there has been a proliferation of low documentation loans, whereby lenders underwrite mortgage loans without checking the current assets or income of loan applicants. MBA believes the use of this type of alternative documentation to streamline the mortgage origination process is justified where sufficiently large downpayments are made.

However, there has been an increasing incidence of low documentation loans with LTV ratios above 80 percent, and they are now approaching 90 percent LTVs. MBA is deeply concerned about the actuarial risks associated with these programs and the excessive risks they pose to the FDIC and FSLIC funds. Further, lenders utilizing more prudent underwriting guidelines relating to high LTV loans cannot compete with these programs.

MBA believes that actions must be taken to reduce the risks associated with low documentation loans, and will work with the supervisory agencies to review these programs.

CONCLUSION

In summary, MBA believes the goals of Congress' effort relating to the thrift crisis should be to:

First, recognize and respond to the scale and basis of the problem, as quickly as possible,

Second, deal with it in a way that is fair to taxpayers, depositors, and sound lending institutions, and

Third, assure the preservation of a finance system that:

- provides affordable mortgage credit with minimum risks to the Federal government, taxpayers, and the secondary mortgage market, and
- provides a secure place for families to store their savings.

Also, we believe Freddie Mac should be restructured so that its Board predominantly represents the interests of its shareholders, and that it is subject to HUD oversight comparable to its secondary market competitor, Fannie Mae.

MBA appreciates the opportunity to testify before this Committee. We would be happy to answer questions or provide additional information, as necessary, for inclusion in the hearing record.

The CHAIRMAN. Let me ask each of you, how would you respond to the idea of strengthening the Qualified Thrift Lender test by taking it up to say 70 percent for housing related activities? Would that be something that you think you could all support?

QUALIFIED THRIFT LENDER TEST

Mr. GOURLEY. We do not have an official policy on that. Our concerns through the years of requiring specific investment by various and sundry institutions would say that we know that there's a need probably—certainly for the near future, there's going to be a need for continued Qualified Thrift Lender test, but to say to increase it we do not have a position one way or the other.

The CHAIRMAN. Mr. Colton.

Mr. COLTON. We do feel that the Qualified Thrift Lender test could and should be strengthened. We indicate that there are two ways to do that. I think we would be comfortable with going to 70 percent as a way of doing that.

We do recognize that there is a need for some flexibility on the part of the savings and loan institutions and that you can constrain them too much. But raising the percentage to 70 percent, and then looking carefully at what goes in that basket probably is appropriate.

We also think it's important to recognize that there is a lot more in that basket than just mortgage originations. We are very concerned about what we refer to as the housing production process i.e. acquisition and development loans and interim financing which make lending possible and the role of the S&L's there. That should and I think will be included in that basket.

The CHAIRMAN. Mr. Blank.

Mr. BLANK. Mr. Chairman, in general, we would agree that the QTL test should and could be strengthened as long as such strengthening is not so rigid that it would cause some healthy S&L's and other thrift institutions to fail. So it must be introduced in a manner that will allow the industry to survive. But certainly, as I said in my original testimony, anything that brings these institutions back into providing housing financing is what we believe in.

The CHAIRMAN. Well, it seems to me taking the test from 60 to 70 percent might help that.

Mr. BLANK. In general, I think it would, but we haven't taken a specific position. We leave that to the Congress to determine.

Mr. GOURLEY. Mr. Chairman, might I just add one thing? Taking it to that and talking, as Mr. Colton did, about what assets are recognized, we would certainly think that the origination side be where that thriftiness test probably should be taken into consideration. So that if they subsequently deliver the loans in the secondary market that they would at least get credit for having put the loans on the books.

The CHAIRMAN. Let me ask you this. Some people argue—it's not my view but others advance the view—that the thrift industry in terms of being critical to meeting housing needs in the country is a fading flower, apart from its other problems, and in fact may not be needed. They argue that if tomorrow the savings and loan industry was to disappear that others are now ready to move in and pick up that activity and do it just as readily through one means or another.

How important is a specialized thrift industry to continuing to meet the mortgage lending needs of the people of the country? Is this really a critical industry in your view, and, therefore, something that has a clear continuing justification?

Mr. Gourley, what's your thought on that?

NEED FOR SEPARATE THRIFT INDUSTRY

Mr. **Gourley**. So far the thrifts have been one of the best delivery system for housing financing in much of the country. Certainly mortgage banking and the secondary market have moved in to be able to find dollars for a lot of the permanent financing that are needed, but there has to be someone out there who can cover the countryside in delivering the product in construction financing, land development lending, and it's going to take a major transition if this industry or something similar did not exist.

The **Chairman**. I take it your answer in essence to my question is, yes, this is a critical industry and it's very important to maintain it.

Mr. **Gourley**. The product is critical.

The **Chairman**. But the point is, is anybody else ready, willing and able to step in and pick up and deliver the product if the savings and loan industry is not there?

Mr. **Gourley**. I don't know of any such at the present, but the marketplace eventually could move in but not now.

The **Chairman**. Of course we don't know quite when eventually is. It could be a long time from now.

Mr. **Colton**. Mr. Chairman, we do feel that a viable thrift industry is an important part of the housing finance delivery system in the country.

I think a lot of people, quite frankly, look at what's happened in the mortgage origination area and say that we could do without a thrift industry when it comes to the mortgage origination side of the business. And I think there may be some flexibility in that area. But there's a lot more to the housing finance delivery system than mortgage originations.

Thrifts now hold over 45 percent of all of the mortgages that have been originated. You've got to clearly have somebody that will invest in those mortgages. There is nobody sitting out there to step in and invest in those mortgages. I think that would have a significant impact if the thrift industry was not involved in the investment capacity.

In addition to that, as I mentioned earlier, the whole process of the housing production system in terms of acquisition and development loans, thrifts make 50 percent of those loans in the country, as well as construction loans that is an important part of the housing delivery system and we think that the thrift industry should be there in order to provide the full range of things that are involved in this viable housing delivery system.

The **Chairman**. Mr. Blank.

Mr. Blank. Mr. Chairman, I've been a residential broker for 43 years and in all of that time I've gone through many marketplaces—tight money, easy money. We have always been able to count on this industry to provide us with basic financing for home buyers.

However, the National Association foresees that it may not just be a thrift industry, but indeed there may be community banks that may want to come into this system and dedicate themselves to the QTL test and make home loans, and we encourage this.

The Chairman. May I just ask, Mr. Colton, what figure do you use as to the percentage of mortgage originations that are done by savings and loans versus everybody else that originates mortgages?

Mr. Colton. I think the most recent numbers that I've seen for savings and loans were in the range of 45 to 50 percent for 1988 on the origination side. The number that I mentioned of 45 percent was also on the investment side. They hold about 45 percent of all the mortgages originated. I can provide you with some detailed numbers on that. I don't have those before me now.

Mr. Gourley. If you'd like, I could give you 1986 and 1987 figures.

The Chairman. I have those. The data which I have is captioned "Mortgage Originations by Institution" and is put out by the Department of Housing and Urban Development. HUD indicates that through the third quarter of 1988, 54 percent of the dollar volume of mortgage originations in the country as a whole came from thrifts, 27 percent of the dollar volume of mortgage originations through the third quarter of 1988 came from commercial banks. Mortgage bankers did 17 percent; life insurance companies, 1 percent; and other very small participants.

The previous year, for the entire year of 1987, the total dollar volume, according to HUD, was 53 percent of the total dollar volume of mortgage originations were done by thrifts; 30 percent by banks; and 15 percent by mortgage bankers.

The reason I take the time to do this—and I'll yield very shortly here to Senator Garn—is that it seems to me when half of the dollar volume of mortgage originations in the country are coming from one institutional sector—namely the savings and loan industry—and if for some reason you were to see the demise of that industry rather quickly or over a short period of time, you would have a tremendous displacement. The degree to which others can and would come in and fill up that mortgage lending need across the country is a debatable question. That's something that we would have to hypothesize because it would be an enormous adjustment that would have to take place, especially if it had to be done in a relatively short period of time.

One of the things that I'm struck by, and I think one of the values that the savings and loan industry structure offers, is that it is out there in virtually every community in the land. It has a grassroots presence and diversification geographically that puts it literally in every community in the country. So, you have a mortgage delivery system in place.

It's true that last year, for example, in two States particularly, Texas and California, you had 59 percent of all of the dollar losses that we saw in the savings and loan system. So you've got, on the positive side, most of the industry healthy thrifts across the country principally engaged in the mortgage lending business. On the other hand, you have these huge dollar problems concentrated in certain areas and with a profile of circumstance that led to the buildup of those problems in those areas.

I'll finish by saying that it seems to me the data that we have indicates that if we were to see the healthy part of this industry to suddenly disappear, it would be a tremendous jolt I think to families and individuals who are out there trying to acquire a mortgage and to move into homeownership.

That's really the driving public purpose behind all this, and I think it's worth taking the time to spell it out a little bit on the record. Sometimes these things get lost when we get into the mechanics of a plan. But that really is the fundamental purpose of preserving this industry.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Let me just follow along that thought because all of you gentlemen here today are interested in the thrift crisis because you've got to maintain a strong housing finance industry. You can't sell any homes if somebody isn't going to finance them and you can't build them. So the chairman has touched on the central point.

Obviously there are many facets to this, but looking at the recommended President's plan, if there were one thing you could change in the plan to strengthen the housing finance industry, let's say the single most important thing, recognizing that there are others, what would your recommendation be as to the most important thing we could do as a Congress to strengthen the mortgage finance industry?

Mr. COLTON. Senator, can I have two?

Senator GARN. No.

RECOMMENDATIONS TO STRENGTHEN THE MORTGAGE FINANCE INDUSTRY

Mr. COLTON. Let me say one first and then I'll just at least allude to the second because I think that's a very appropriate question.

In our view, I suppose the greatest concern that we have is to clarify the issue around capital. The structural issues are very important, but ultimately, to be perfectly candid, capital requirements will allocate credit for the years to come in the country and so setting forth those capital requirements we think are at the heart of what needs to be clarified.

With that in mind, what we've said is that there really is confusion in the legislation with respect to capital requirements and we hope that Congress will focus on that and not just say that it ought to be more stringent than the banks, but try to set forth some principles which will establish clear parity and clear guidelines in terms of where capital ought to go. But it will certainly also be based on the Basel accord which basically does set forth the importance of housing as a stable sector of the economy.

Having said that's the most important issue, probably the most politically sensitive issue which we are concerned about is the one which relates to maintaining the integrity of the bank system.

Senator GARN. Before you leave that one, let me comment. You mentioned the Basel accord which set capital standards primarily for commercial banks. Thrifts are much more interest rate sensitive than banks. So the Federal Home Loan Bank Board is recommending that higher capital standards be set there to recognize that interest rate sensitivity.

Do you think that's valid—that because thrifts are more interest rate sensitive than banks, that there ought to be some deviations from Basel because those standards were set for commercial banks?

Mr. COLTON. We think that Basel sort of provides a foundation for parity. We also recognize that there are some special considerations and have worked closely with the Federal Home Loan Bank Board on their proposed capital regulations.

They do make a provision for interest rate sensitivity and, quite frankly, we're comfortable with doing something along those lines.

We are quite concerned about the specific provisions that the bank board is talking about. First of all, they have not really laid them out so anybody can analyze them in any depth, and yet they want us to comment by March 23. So we've had some concerns about that.

In addition, it appears that if you take the risk-based portion of their rules, that would be 6 percent capital requirements. If you add to that the interest rate provisions, the capital requirements for the S&L's could be as high as an additional 4 or 5 percent. So they could be up at 11 or 12 percent in terms of their capital requirements as compared to 6 to 8 percent for the banks.

We think it's very important that you look at interest rate sensitivity, but the specifics of that provision have raised some concerns in our mind. And that is, in part, why we said it would be helpful for Congress to try to at least lay out a foundation of parity so that we could deal with this as we move forward.

Senator GARN. Without dealing with the numbers, you do agree that there should be some additional capital for interest rate risk?

Mr. COLTON. Surely. Also, you can deal with that in a regulatory manner too. But we think that interest rate risk is something that ought to be looked at, but it ought to be looked at within appropriate bounds.

Senator GARN. OK. Now your second most important.

Mr. COLTON. I just wanted to say that I think the second issue we are very concerned about is something we call the integrity of the bank system. And although we have been willing to accept in our proposals and recognize why the Treasury has proposed oversight by the Treasury Department, we do think that it is very important that the bank system have clear rulemaking authorities, clear enforcement authority, clear capital-setting authority, in terms of what they have vis-a-vis the FDIC, and we do think that it's possible to design a system where the Federal Home Loan Banks maintain an independence when it comes to their borrowings with respect to their advances.

Senator GARN. Mr. Gourley.

Mr. GOURLEY. Kent is very eloquent. He just took the one that we would put at the top of the list I think. That's keeping the independence of the Federal Home Loan Bank Board System. Certainly

I've spoken earlier about Freddie Mac. Well, that's another independence.

But just in keeping the marketplace free to operate as it should, keeping it away from Treasury, we think it should operate independently.

Senator GARN. I like your answer.

Mr. Blank.

Mr. BLANK. I think one of the greatest things that can come out of this act is the restoration of confidence to the savers of America that the money that they put into these institutions is indeed safe. Even though the President has come out and said every depositor in a thrift is guaranteed up to the full amount of $100,000, unfortunately, there have been withdrawals from these institutions and I think we want to restore confidence.

I think one of the things that can be done to restore confidence and to help the system—and I admire the administration's stand—is that they will give the FDIC jurisdiction over State-chartered thrifts. It is State-charter thrifts action that have contributed so much, as you said, in Texas and California to their going under. We also think that by applying these same rules to State-chartered banks, which are after all part of the financial system which this country stands behind, it would hasten restoration of confidence and bringing them all under these same rules as propounded by the bill.

Senator GARN. Well, the chairman will like that answer. Thank you. My time is up.

The CHAIRMAN. The chairman did like that answer.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Isn't one of the big issues here, long-range issues, is who's going to supply a viable source of mortgage funds for housing in America in the future? Isn't that the central question?

Mr. COLTON. Yes, absolutely.

Senator SHELBY. And along those same lines, hasn't securitization, which you're all familiar with—you work with it every day, especially the mortgage bankers—hasn't that changed the parameters of what the savings and loans as we know them will do in the future? Will there be a blurring of banks and savings and loans after this crisis, after the shakeout, because of securitization and the need to compete in other services?

SECURITIZATION

Mr. BLANK. Well, our association years ago supported bills in Congress that would bring pension funds and outside money into this industry, particularly back in 1981 when funds were so scarce, and we're very happy to see what has happened with mortgage-backed securities such as REMIC's, and CMO's.

But on the other hand, there are competing demands for funds—industry, consumer financing, and we still think it is important to continue to preserve an organization that is dedicated solely to making—or almost solely to making—loans to the people of America who need home loans. So we don't want to depend 100 percent on any one type of home mortgage lending organization. We like competition. Competition brings our home buyers better——

Senator SHELBY. You also like stability, don't you, which comes from confidence in anything?

Mr. BLANK. Absolutely.

Senator SHELBY. Stability in the marketplace.

Mr. BLANK. Absolutely.

Senator SHELBY. Mr. Colton, go ahead.

Mr. COLTON. On this issue I think we share the concern that Chairman Riegle just raised, that if in fact you removed the savings and loan industry from this system, it would clearly take away from the capability and stability of the system.

I think, quite frankly, that there's a feeling out there—that people I suspect are correctly mad about what's happened in the savings and loan industry, and there is a desire to punish, if you will. I think what Congress needs to do is to find that delicate balance, which will say, yes, the system needs to be reformed, but how do we within the context of that reform, maintain stability of that system.

I think there will be, as the process shakes out, some homogenization. But I think the focus, if we maintain a viable Federal Home Loan Bank System, have a solid Qualified Thrift Lender test, and a solid advance window program as a part of that system, will be that community-based institutions will tend to be thrifts, whether they are banks or S&L's, and will want to fit under that Qualified Lender test. That's where the stability will come for housing finance in the years to come, and the larger banks will be international banks, like Citicorp, who will be involved in a broad range of issues related to both national and international issues.

Senator SHELBY. But would you basically agree that money will find any bank, whether it's an international bank or whether it's a savings bank, if they have confidence in the institution, large or small? Second, if the rates are right?

Mr. COLTON. Yes. Confidence is absolutely essential. You just hit on the other important point affecting housing, that if we do not have a viable system, there will be money for housing, but it will cost a lot more for the home buyer and that's why we need a viable thrift system.

Senator SHELBY. Mr. Gourley, what about securitization now? You're a mortgage banker.

Mr. GOURLEY. Well, securitization has made all the difference in the world in the secondary market. It has made it possible for us to have a regular flow of money into the mortgage market through thick and thin. We have not had the lack that we have had in the past where disintermediation came into play. We've been able to find the money for long-term financing.

The thing I would say, once I've said that, is that we still need the delivery system and the time that it takes to develop a delivery system if the thrifts were to be gone. So we still say they presently offer the best delivery system in many markets and as mortgage bankers we have thrift members and commercial banks. I represent all.

CONFIDENCE IN THE SYSTEM

Senator **Shelby**. Let me get back on one thing. We were talking about confidence. Confidence is the most important thing in banking I believe, that the people have confidence in where their money is. You're saying, well, when are we going to restore confidence? Well, the Wall Street Journal this morning said regulators put 45 more insolvent savings and loan on the roster of thrifts and lists them, and two of them are in my home State of Alabama, a lot of them in Texas and Colorado and everything else. This isn't going to restore any confidence. This program is going to have to bottom out.

There's going to continue to be, I believe, a silent run on money—it always is—because if people don't feel confident or feel a little uneasy, there's going to be that silent movement of money, probably a lot of it from the savings and loans to the banks that's got the sticker on it with FDIC, some into mutual funds and elsewhere. And until it bottoms out, we can say everything we want to, and the President can say we're going to back the money, but the little depositor out in America, they're going to say, "Well, I'm not sure."

Mr. **Blank**. I was just talking to my stockbroker yesterday and he said they're getting tremendous amounts of funds from out of the savings accounts and into the money markets. Well, that money is needed in other funds, too, but we need that in the thrift industry to provide home loans.

I think the greatest thing that can happen to restore confidence after all this dies down is that when they see that FDIC logo on the local thrift organization—true, it will have a SAIF—and incidentally, that's a great acronym, SAIF—a SAIF under it for the savings and loans and a BIF for the banks. But seeing that logo on there and knowing that the full faith and strength of the U.S. Government is behind that deposit, I think the money will flow back.

Mr. **Colton**. I think, Senator, what you said just emphasizes the importance for rapid action by the Congress on this legislation so that we can try to put this issue behind us.

Senator **Shelby**. Well, I can tell all of you, the chairman and others on the committee and this Senator too, we're on a fast track, but sometimes it's such a big issue and so much money involved, we don't want you to come back—not you, but others—to come back to this committee over and over. We want to solve the problem and take the hit now.

Mr. Chairman, thank you.

The **Chairman**. Thank you, Senator Shelby. I think you stated it exactly right. The intent is to not only get this job done quickly but we want to do it once and for all with a solution that's going to hold up and stand the test of time. That's why your suggestions for modifications and adjustments to the bill are very important to us. We're going to weigh them very carefully because we're going to work off the administration's bill as the vehicle by which we solve this problem, and we will make some adjustments to it.

Former Chairman Garn has some specific thoughts in mind along those lines. I do. Other colleagues do. But I think we are beginning to see the outlines of a set of adjustments that will give us a good strong, solid system for the future where we really contain any real risk of another catastrophic failure. That's what of course has happened here.

FIFTY-STATE FEDERAL CHARTER

Let me ask you one other thing that I want to get into. That is, I feel very strongly that once we've designed a Federal charter for a federally insured savings and loan, that that ought to be a 50-State charter. And that if States should decide that they want to add other activities that have a different risk profile than we have agreed on at the Federal level, than those activities should not have any connection at all to the Federal deposit insurance system. We should have an absolute disconnect between those things that States may wish to add and in a sense put that new risk on the Federal taxpayer and the Federal treasury.

I think the profile of how this problem evolved shows that the worst part of the problem occurred in the States with the most wide-ranging powers and, of course, they are not responsible now for paying for the losses that have piled up. The Federal Government is. The Federal Deposit Insurance System is. In fact, it's broken the insurance system and we're out of money because those losses have grown to such a size.

I feel very strongly that any State activities that are add-ons to a Federal charter ought not to be connected to Federal deposit insurance.

Would your organizations share that view?

Mr. BLANK. Yes, we certainly feel that if they are not going to abide by the rules of the Qualified Thrift Plan that they should not have Federal insurance. We would certainly support that concept.

The CHAIRMAN. Mr. Colton.

Mr. COLTON. Although NAHB has not had firm policy on that, I think we would basically agree with your premise. I think you've mentioned and others have mentioned where the problems have come in the past. They are State-chartered institutions who have behaved I think in some ways that have been very detrimental. I think if it's insured by the Federal Government there ought to be one set of standards for that insurance.

The CHAIRMAN. Very good. Mr. Gourley.

Mr. GOURLEY. I would agree with that, and certainly the supervision at the State level and the Federal level both left something to be desired along the way and certainly if the Federal Government is going to insure it, then they need to have more control over what it is they're insuring.

We do not have a formal policy on that, but I think we would do so.

The CHAIRMAN. Well, that's a useful answer and it's important for you to know another point related to that that we've developed from earlier testimony. When you leave aside the structural reform side of the administration package and you turn to the manner in which it's to be paid, we don't know the ultimate cost of the approach that's been suggested by the administration, and in effect, is we are creating a funding mechanism that you might call a blank check. In other words, we provide the authority for the Government to pay whatever the ultimate cost turns out to be. Some people think it's much higher than what is in the administration's calculation or number. CBO has come in with a higher figure, as another agency of Government that's taken a look at it and so forth.

Whatever the final figure turns out to be, it seems to me that if we're going to find ourselves in a situation where we obligate ourselves to an unknown cost in the future that has already in effect occurred and is occurring now, that that is just one more argument in my mind at least that says I just don't think we can put the Federal taxpayer and the Federal guarantees on the line again for activities that we don't authorize.

After $100 billion or more has disappeared out of the system with a lot of pain and a lot of sacrifice by the American people, the notion that somehow or another we're going to continue to provide Federal insurance and Federal backup and the Federal taxpayer to pay for things that individual States may dream up, I think is absolutely wrong and illogical. If States want to go off into other activities, they're certainly free to do that. If they want to craft additional businesses, they can set up an insurance fund of their own. But the notion of letting the States experiment in this area and expect the Federal taxpayer to be there to pick up the check in the end if the thing goes in a calamitous direction is wrong, I don't think we can do that again, nor should we do it. I think there are plenty of ways that we can experiment and can have innovation without putting the Federal taxpayer on the dotted line to have to pay for the problem if it blows up at some point.

You're all nodding in the affirmative. I know the stenographer won't record that, but I take it you basically all agree with that concept, is that right?

Mr. GOURLEY. Yes, sir.

Mr. COLTON. Yes.

Mr. BLANK. Yes, sir.

The CHAIRMAN. Let me now yield to Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

All of you have expressed some opinions on what we ought to do with Freddie Mac. Mr. Gourley, have you had any chance to review the compromise proposal the Federal Home Loan Bank Board has released?

Mr. GOURLEY. I don't think I have seen that. We have not looked at one beyond S. 493 that we were supporting and the proposal for a three-member board, and I was going to add to that, Senator Shelby mentioned a minute ago the importance of the secondary market, we believe that keeping that independence there at Freddie Mac is very important to the secondary market and, in answering, a very important housing related issue.

Senator GARN. Well, all of you have talked about various aspects about how this should be done. I'll just ask you a general question.

Wouldn't the best solution be to make it private—privatization?

PRIVATIZATION

Mr. COLTON. The question is what does privatization mean? We certainly feel in terms of the structure of the board that if you can privatize that structure in terms of using a structure much like Fannie Mae's, that in fact makes a lot of sense.

We do think that because of the history over time there should be in any proposal a continuation of some link to the Treasury Department and the Federal Home Loan Bank System. The proposal in S. 493 would have the link to the Treasury Department, as Fannie Mae does, as opposed to the Federal Home Loan Bank System, which is the way the current structure ties Freddie Mac in. But I think Freddie Mac and Fannie Mae are viewed in the marketplace as having the implicit backing of the Federal Government and in that case we feel that that should continue.

But the privatization of the Board seems to make a great deal of sense to us as we look to the future.

Senator GARN. Mr. Blank.

Mr. BLANK. Our association has not taken any stand on Freddie Mac's privatization. However, we do believe that the makeup of the Freddie Mac board as proposed in the Cranston-D'Amato bill is a good thing. After all, Freddie Mac is out there buying loans and competing in essence with Fannie Mae, and there are all kinds of new market innovations that come about in the marketplace, and we feel that such a board would help to promote this type of activity and make a level playing field as between these two purchasers of mortgages in the secondary mortgage market.

So we would like to see the Freddie Mac board restructured. I don't think the way the administration bill comes out will achieve this and, therefore, we support the Cranston-D'Amato approach.

Senator GARN. Mr. Gourley.

Mr. GOURLEY. Well, we strongly support S. 493 and believe that the Fannie Mae structure for the secondary mortgage market is very important and it's very important to keep both these players there. We like them as competitors because as it does in any competition it helps keep the marketplace honest. It's very important that they have the linkage that they presently have because the housing industry needs this support. So we want Fannie Mae as it is, maybe with a little more independence along the line, but right now we like Fannie as it is and Freddie to look like Fannie insofar as the Board structure—independent.

Senator GARN. Mr. Blank, we've had a lot of discussion about what the RTC does with the disposition of assets. It's probably more important to you, as a realtor, than to anybody else, that local real estate markets are not depressed. I've heard Chairman Wall say on numerous occasions that the two worst things we could do with those assets are either not sell any of them or sell all of them. I agree with that.

Do you, as a realtor, have any recommendations on how we might dispose of those assets? What kind of a method might we use so that we are helping the FSLIC as far as recovering some assets, but on the other hand, so that we're not depressing local real estate markets?

DISPOSITION OF ASSETS

Mr. BLANK. Senator Garn, there's going to be literally billions of dollars of real estate assets that are in REO's that will have to be handled by this new RTC and we have found that in some areas that the dumping of these REO's, just selling them off at any cost just to get rid of them, can have a very deleterious effect on the surrounding marketplace. In fact, in dumping some of these assets at a very low price it lowers the value of other assets that may be in the portfolio of the thrift, which in turn can affect their safety and security and soundness.

Furthermore, we feel that there can be a method of handling these REO's that may bring more money back in the sale. For instance, we believe that there should be experienced professionals in real estate involved with the RTC—real estate managers, real estate marketing people—who can have a business plan drawn up for each major REO property. A lot of times by changing the use of a property, sometimes even the bare land—tearing the building down—will bring a better price, as an example, or changing the use to a different type of rental property and managing it prudently and holding it for a while and building up the income will build up the value.

In order to do this, we feel the RTC must have some kind of local offices and give these people in those offices the autonomy to sell and negotiate for these properties within certain parameters. But definitely there must be people who are experienced in real estate management and marketing in order to bring out the highest and best use and thus the best price and to market these in an orderly fashion, using professionals to assist the RTC in marketing them.

Senator **Garn**. Well, there are obviously big geographical differences around the country, too. The Washington area could use some depressing of the market. I should probably be sent to jail for what I sold my house for in McLean, VA. I certainly would not pay that much for a house that I lived in for 12 years.

Mr. **Colton**. Mr. Chairman, I wonder if I could just comment on that because I think you hit on a major issue. As we looked at the legislation, the RTC as laid out by the administration is really just an overview corporation which really does not have a plan or structure to focus on those assets. We do hope that's one of the areas where Congress will think seriously about either asking them to produce a plan within 3 months so that you have some sense as to what the purpose and concept is and the philosophy, or thinking about getting into structures. As you mentioned, there are very significant differences in markets. We've thought about whether you could have regional advisory boards that could make a difference to the RTC. Do you facilitate public-private interaction? How can you best do that? The bill talks about contracting with the FDIC, but I think there are a number of other people that RTC would want to contract with.

So we think this is an area where Congress can probably fine-tune this legislation by working with the administration and others to be a little bit more specific about how to manage those assets. It's a very important problem.

Senator **Garn**. Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Garn.

I appreciate the testimony you've all given today. There will be other questions that other colleagues who could not be present this morning will want to have you respond to for the record and I may have some additional ones myself.

I'll just conclude by saying that we have now finished our second to the last week of hearings and so we have one more week of hearings to do next week. We're going to march right through those hearings and finish on schedule, barring any unforeseen event. And then we will use the recess period upcoming to develop a committee print. Senator Garn and I have been working and talking and counseling together, as we both have with other members of the committee, so we hope to be able to put together a sound committee print during that period and be ready for committee markup when we come back from that recess.

I feel very good about the progress we've made. I want to also say to the staff how much I appreciate the great job that they have been doing on both sides. I think this is an extraordinary problem and it's requiring a tremendous amount of personal and professional work time by the staff members and they are putting in long hours day and night 7 days a week, and that is greatly appreciated. I want to thank them for that. It's an important public service.

Our colleagues have also been working very hard. We've had a lot of other things going on with the Tower nomination and hearings virtually every day in the Banking Committee and the Finance Committee and people have had to come and go to be in other committees when necessary and as well here. But I think the members of the committee have put a tremendous amount of time and effort in to develop this hearing record and it's been very valuable and I think it puts us in a position to write a very good bill and one that's going to serve the national interest.

So with that, I thank our witnesses today.

The committee stands in recess until next week.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

Questions for the Record of Senator Donald W. Riegle, Jr. for James Blum, Acting Director, Congressional Budget Office - Hearing of March 3, 1989

Question: In your estimates of the uses and sources of cash under the Administration's plan, you make no allowances for the tax losses associated with the FSLIC's 1988 merger assistance and future assistance agreements, or for the tax deductibility of insurance premiums by profitable thrifts. What do you estimate the effects of these tax benefits are on Treasury cash needs, including interest on Treasury borrowing?

Answer: CBO's estimates do not incorporate any effects of the tax deductibility of the insurance premiums for profitable thrifts. The premiums are a deductible expense to thrifts, which in isolation would reduce thrifts' income subject to the corporate income tax and therefore their tax liability. Several factors may offset this effect, however. First, these thrifts may pass through some of the increased premiums to their customers, by either raising interest rates for loans or reducing interest rates on deposits. This passthrough is made more likely by the Administration's plan to increase the insurance premiums for commercial banks as well as thrifts. Second, firms with products that compete with insured deposits might experience an improved competitive position and higher profits. As a result of these offsetting effects, we do not expect increased insurance premiums to have a significant effect on aggregate corporate profits or income tax receipts.

The Joint Committee on Taxation (JCT) estimates that, as a result of FSLIC-assisted mergers during calendar year 1988, expected corporate income tax receipts will be reduced by $6.9 billion over the 1988-1994 period. The year-by-year revenue effects are as follows:

Effect of FSLIC-Assisted Mergers in 1988
on Corporate Income Tax Receipts
(By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993	1994	1988-1994
Change in Receipts	-0.1	-1.2	-1.3	-1.1	-1.3	-1.0	-0.9	-6.9

We estimate that any Treasury borrowing to fund these revenue losses would generate $0.2 billion in debt service in 1990 and $2.1 billion over the entire projection period through 1994.

Further revenue losses are possible from assisted mergers concluded during 1989, after which the special tax rules relating to assisted mergers are scheduled to expire. CBO has asked the Joint Committee on Taxation to investigate this 1989 effect as well. At this time, we cannot estimate the revenue loss from these 1989 deals or the effect on Treasury borrowing. The calculation is difficult partly because it is not known what form each assisted merger will take. In addition, because the tax benefits were reduced beginning January 1, 1989, data for 1988 is not directly relevant.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
PETER TREADWAY

Q.1. Would it be accurate to describe the thrift industry as having grown excessively? Why?

Q.1. I believe that it would be correct to describe the thrift industry as having grown excessively. By allowing and sometimes encouraging firms which were undercapitalized or without capital to try to grow their way out problems and by not insisting that these firms raise capital, the FSLIC encouraged a growth of the industry which exceeded that which its capital levels could support.

Q.2. You testified that many thrift institutions will have difficulty raising substantial amounts of new capital during the next several years, whether through retained earnings or from investors. Does that difficulty reflect a judgment by the markets that such institutions will not, in the long run, be economically viable (e.g., because of overcapacity in the industry)?

Q.2. Many thrift institutions will have difficulty raising substantial amounts of capital during the next several years because their expected rate of return is too low which, a) will not permit a sufficient retention of capital so as to build up capital and b) will not attract outside investor capital. The low expected rate of return is itself a result of overcapacity. The reduction of overcapacity implied by implementation of the Administration's Plan will eliminate this overcapacity and raise the overall rate of returns for the industry as a whole.

Q.3. The Administration's proposal would prohibit thrift institutions from growing after June 1, 1991 unless they meet bank-type capital standards.

(a) Will the requirement cause many marginally healthy thrift institutions to fail?

(b) Is the requirement unduly stringent?

(c) In the long run, are the losses to the deposit insurance fund likely to be higher -- or lower -- under the Administration's proposal than they would be if institutions had more time to meet the higher capital standards (e.g., if an institution that could show that it was profitable and that its capital was increasing)?

(d) What (if any) would be the effect on well-capitalized institutions of giving weak institutions more time to meet the new capital standards?

Q.3. a. I am unclear as to what is meant by "marginally healthy." The Administration's plan will cause marginally capitalized institutions either to, a) raise additional capital thus diluting existing shareholders' equity or b) to be sold to and consolidated into more profitable institutions. This is a necessary process since, in fact, these marginally capitilized institutions have already lost their shareholders' investment in becoming marginally capitalized and are getting a free ride off of FSLIC insurance which for them is a substitute for capital.

b. The requirement is not unduly stringent but in fact absolutely necessary as is argued in Q.3.a.

c. I firmly believe that the losses to the deposit fund are likely to be lower under the Administration's proposal than they would be if the institutions had more time to meet higher capital standards.

First to commit new capital to the industry, investors must be offered a competitive rate of return. Perpetuating overcapacity is not the way to do this.

Second, undercapitalized institutions have every incentive to take excessive risks to try to rebuild their capital positions -- "Heads we win, tails the deposit fund loses." The Financial Corporation of America (FCA) is a classic example of where the FSLIC, because it did not have the funds to liquidate FCA and because it was unwilling (or unable) to force FCA to sell new shares, in 1985 allowed a massive interest rate gamble which ultimately cost the FSLIC dearly. FCA massively expanded its balance sheet by originating fixed rate mortgages and buying Mortgage Backed Securities and funding these short term. The gamble failed when interest rates rose. To allow undercapitalized thrifts to grow to meet capital standards is to risk the creation of new FCAs. The only reason for delaying the June 1, 1991 date slightly is the possible logjam in raising capital for and or selling off so many undercapitalized thrifts.

d. The effect on well capitalized institutions of giving weak institutions more time to meet new capital standards is to lower their rates of return and in effect penalize them for maintaining adequate levels of capital.

Q.4. Many thrift institutions in the Southwest contend (a) that they cannot possibly raise enough capital to comply with the 1991 deadline, and (b) that they could not substantially increase their capital ratios if they were prohibited from growing. Do you agree?

Q.4. In my opinion, the undercapitlized institutions in the Southwest as a group are not likely ever to become adequately capitalized by a growth strategy. They will not be able to meet any deadline unless they undertake a program of excessive risk-taking which is blessed by some fairly implausible macroeconomic luck, eg., $30/ barrel oil, rising Southwest real estate prices and 5% mortgage rates.

What they are asking is that FSLIC insurance continue to be given to them at a price far below its true cost and that this insurance continue to substitute for capital. Without FSLIC insurance, depositors runs would quickly shut these institutions down.

Q.5. Some thrift institutions contend that the thrift industry's problems are largely the result of adverse economic conditions, such as a regional depression in the Southwest.

(a) Do you agree?

(b) How significant have mismanagement and overcapacity been in creating the industry's problems?

Q.5. a. Unquestionably, adverse economic conditions have contributed to the thrift industry's problems. Adverse economic conditions from time to time afflict almost all U.S. industries. For example, the oil industry in the Southwest has suffered a serious contraction due to these same adverse economic conditions. This contraction has not required a $150 billion dollar clean-up or special subsidies from the U.S. taxpayer.

b. The fundamental cause of the Savings and Loans problem in my opinion, was the FSLIC deposit insurance system. The FSLIC essentially insured all thrifts regardless of their level of capital. No action or insufficient action was taken aganist most companies which were deficient in capital or with negative capital. Managements had every incentive to take excessive risks; depositors had no incentive to avoid insolvent or marginally insolvent companies. Compounding the problem, the Federal Home Loan Banks apparently were quite lax in their supervision of institutions in the deregulation period from 1982-87. The FSLIC in effect handed out its guarantee freely which served as a substitute for capital; unscrupulous managements invariably saw this as an irresitable opportunity which was enhanced by lack of supervision. This system was heading for collapse. The Southwest economic downturn in some ways was a blessing in that it brought about the collapse sooner rather than later.

Q.6. Some thrift institutions that acquired failing institutions in the early 1980s have large amounts of goodwill on their books, which is currently being amortized over periods much longer than the 10-year maximum proposed by the Administration.

(a) These institutions contend that they performed a valuable public service by making the acquisitions in question, and that the goodwill they carry on their books was a primary incentive for the acquisitions -- a substitute for cash or other assistance. Do you agree?

(b) Would it be good public policy to permit such institutions to continue using the current amortization schedules, even if that resulted in permitting them to operate without any tangible equity capital?

(c) Is it really accurate to say that the goodwill in question here reflects the franchise value of the acquired institutions?

Q.6. a. Regarding the goodwill issue, policymakers have a dilema here. The regulators encouraged savings and loans to acquire failing institutions, incurr goodwill and for regulatory capital purposes amortize this goodwill over 30-40 years. Most transactions were carried out by the mutual companies in the early 1980s.

In my opinion, by agreeing to this treatment of goodwill the regulators made a mistake. The treatment was too lenient. However, a "deal is a deal" and these transactions were presumably entered into with good faith by the institutions involved.

I have therefore quite reluctantly concluded that the institutions are justified in arguing that the 10 year schedule is unfair.

b. I believe amortization schedules previously agreed upon should continue to be used, even if this results in no tangible equity capital.

c. It is correct to say that the goodwill in question represents the franchise value of the acquired institutions. I believe it is also true that the bulk of goodwill occurred in the assisted transactions among mutuals is an overstatement of this franchise value and 30-40 year amortization periods are too slow. Had these acquirers been stock companies, many of the transactions probably woud not have occurred. Once again, the regulators made a bad deal.

Q.7. Chairman Wall of the Federal Home Loan Bank Board testified on March 1, 1989, that the proposed Federal Home Loan Bank System "must have the same latitude as the Office of the Comptroller of the Currency. To give it less or to leave more with the FDIC or the surviving insurance entity is to put the thrift industry . . . at a disadvantage as far as the going forward possibilities and opportunities of the industry is concerned."

(a) Do you believe that the future prosperity of the thrift industry depends on having a sympathetic regulatory agency that is able to bend the rules?

(b) People often speak of the Bank Board as having a legal duty to promote the thrift industry, and contrast it with the Federal bank regulatory agencies -- which have no such duty. Does the thrift industry really need to have its regulator also serve as a promoter of the industry?

Q.7. a. The question (Q.7.a) as posed a "Do you believe the future prosperity of the thrift industry depends on having a sympathetic regulatory agency that is able to bend the rules?" is a loaded one. Unfortunately, given what has happened, it is a very good question and one which deserves a resounding "No" as an answer.

b. The thrift industry definitely does not really need to have its regulator also serve as a promoter of the industry.

Q.8. What possible justification would there be for permitting Federal thrift regulators to prescribe accounting standards different from those of the Federal banking agencies? Is it desirable for thrift regulators to have such authority?

Q.8. There is no justification and it is not desirable to permit Federal thrift regulators to prescribe accounting standards different from those of Federal banking agencies.

Q.9. Do you believe that thrift institutions can and will continue to be viable as portfolio lenders?

Q.9. a. I believe a greatly reduced number of thrift institutions can and will be viable as portfolio lenders provided: 1) The same sound capital guidelines are impartially enforced on all banks and thrifts. Undercapitalized banks and thrifts should be forced to either raise capital, shrink down, sell out or liquidate in an orderly manner; 2) The issue of thrifts' competitive equality regarding access to capital, capital adequacy and taxes vis a vis Fannie Mae and Freddie Mac is addressed; 3) The Federal Home Loan Banks are not systematically de-capitalized as per the President's Plan; 4) Thrift and bank deposit insurance fees are brought into equality.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
BARNEY R. BEEKSMA

Q.1. Please give us the strongest justification you can of why we need a specialized, subsidized, separately regulated thrift industry.

A.1. This nation needs a specialized, subsidized, separately regulated savings institutions business for the following reasons:

(a) Most other nations decided, like we did prior to the Great Depression, that the needs of homebuyers could only be met over the long-term by a specialized group of lenders.

(b) Only savings institutions have demonstrated a consistent commitment to housing finance throughout their history. And only savings institutions have remained committed to housing finance during all phases of economic cycles.

(c) Despite the problems of a minority of savings institutions in recent years, the Federal Home Loan Bank System has worked extraordinarily well in fostering the national goal of homeownership by supporting a strong savings institutions business.

(d) The alternative to specialized housing lenders is a return to the pre-'30s dependence on the capital markets for funds for housing. Dependence on the capital markets subjects homebuyers to uncertainties about interest rates and the availability of funds, and deprives homebuyers and housing finance of the unique benefits provided by specialized mortgage lenders.

These benefits include: a clear incentive for better loan servicing to minimize customer complaints because of other relationships savings institutions have with borrowers; reasonable forbearance when local economic conditions cause problems for borrowers -- a course of action capital market investors have little interest in; a strong self-interest in performing quality underwriting of loans, especially those held in portfolio; potentially faster processing of loans, especially in comparison with Federal Housing Administration and Veterans Administration loans; the ability to design loans to meet changing local market conditions; a willingness to make special types of loans that are not saleable in the national capital markets; and the greater innovation in developing mortgage products that comes from having several thousand private sector firms focusing on mortgage finance.

Q.2. The thrift industry has long sought to maintain an identity separate from that of commercial banks and to preserve a system of subsidies and separate regulation. So why wouldn't the industry want to have a deposit insurance logo clearly differentiated from that of commercial banks?

A.2. Maintaining an identity separate from that of commercial banks and preserving a system of subsidies and separate regulation does not depend on having a separate insurer or a separate insurance logo. Until very recently when the problems of the Federal Savings and Loan Insurance Corporation made the FSLIC a household name, the public had difficulty even identifying the FSLIC as the insurer of deposits at savings institutions. Perhaps because there are five times as many commercial banks as savings institutions, the FDIC is the much better known of the insuring agencies.

Our goal in seeking a single insurance logo for commercial banks and savings institutions is to restore public confidence in our remaining healthy institutions and to thereby reduce their cost of funds.

Q.3. Under the Administration's proposal, a thrift institution that persistently fails the qualified thrift lender test would eventually be treated as a bank. Do you support that provision?

No. We prefer an amendment, a copy of which was forwarded to Sen. Riegle by Kenneth D. Seaton on March 16, that:

(a) requires an institution to maintain a qualified thrift lender percentage of 60% to avoid losing its thrift charter;
(b) increases to 70% the QTL that must be met for purposes of holding company powers and access to advances; and
(c) widens the qualifying assets for QTL purposes to include loans for churches, schools, hospitals and nursing care facilities, as well as loans for personal, household and family purposes, and increases the aggregate percentage of tangible assets ceiling for liquidity assets and the mortgage banking credit to 25%.

Q.4. Do you believe that thrift institutions should be subject to a strong qualified thrift lender test which ensures that they center their activities on housing finance?

A.4. Yes. We support an amendment, described above, to subject savings institutions to a strengthened qualified thrift lender test. Savings institutions are primarily housing lenders. Those that remained in home lending are today the healthy institutions -- the survivors.

Q.5. Do you believe that thrift institutions can and will continue to be viable as portfolio lenders?

A.5. Yes. An informal study done by the U.S. League found that savings institutions holding 50% or more of their total assets in residential mortgages have been the most profitable in the business since 1985. In the aggregate, these institutions had 63% of their assets in home loans and another 8% in mortgage-backed securities.

Jonathan E. Gray, senior research analyst for Sanford C. Bernstein & Co., Inc., said in a December 1988 report: "The strongest 70% of FSLIC-insured savings and loans, with assets of roughly $900 billion, exhibit profitability and balance sheet characteristics comparable to those of the U.S. banking system. This sector of the industry is certainly viable provided its capital is not confiscated in a futile effort to force it to pick up the tab for losses that are not of its making."

Q.6. If the proposed Federal Home Loan Bank System were independent of the Treasury, what would prevent it from being overly close to the thrift industry?

A.6. The administration's bill contains two major provisions, which we strongly support, that will ensure an arms length relationship between the newly constituted Federal Home Loan Bank System and the savings institutions business:

(a) The bill would shift the function of promoting the safety and soundness of savings institutions from the FSLIC, currently a part of the Federal Home Loan Bank System, to the independent Federal Deposit Insurance Corporation.

(b) Under the administration's bill, the senior supervisory employee of each Federal Home Loan Bank would report to the chief supervisory official of the Federal Home Loan Bank System. This provision of the bill, which we support, would remove the existing supervisory function from the presidents of the district banks.

Q.7. You testified that the League endorses "risk-based capital guidelines phased in over an appropriate period of time and with appropriate grandfathering."

Q.7(a). What is the difference in this context between "grandfathering" and forbearance? Would "grandfathering" be a mandatory, long-term form of forbearance?

A.7(a). What we meant in our testimony by "appropriate grandfathering" was the treatment of goodwill and deferred loan losses. We are seeking grandfathering of the existing accounting treatment of goodwill and deferred loan losses. The use of the term "forbearance" would erroneously suggest that the existing rules prohibit the inclusion of goodwill and deferred loan losses in capital. They do not. We do not consider the grandfathering of these items as "forbearance."

Q.7(b). Isn't your call for "grandfathering" inconsistent with your testimony supporting "strong capital requirements identical for all depository institutions, be they commercial banks, credit unions, or savings and loans"?

A.7(b). In the summary of our testimony, we may have left the impression that we were seeking identical capital requirements for all depository institutions immediately. Our full statement clarifies that we support "applying the same risk-based capital rules to all financial institutions _after an appropriate transition period and with reasonable grandfathering provisions_" (emphasis added). We see no inconsistency in grandfathering components of capital that are accepted under Generally Accepted Accounting Principles even though they are not now accepted by the commercial bank regulators.

Q.7(c). Do the capital requirements applicable to commercial banks or credit unions contain "grandfathering" of the kind you propose? If so, describe the grandfathering and identify the regulations in which it is set forth.

A.7(c). Yes. Commercial bank capital requirements are grandfathered in the sense that they deviate significantly from GAAP. Bank RAP capital equals GAAP plus allowances for loan losses, plus minority interests in consolidated subsidiaries, plus the unamortized balance of intangible assets booked prior to April 15, 1982, plus total mandatory convertible debt, less other identifiable intangible assets, less goodwill.

Q.8. You testify that the League "endorse[s] the use of GAAP accounting standards by all types of financial institutions." Do you agree, then, that "deferred loan losses" and other vestiges of regulatory accounting principles (RAP) should be laid to rest?

A.8. Yes. But there must be a reasonable transition period. It must be acknowledged that savings institutions have used regulatory accounting principles in good faith. In many cases, the regulators urged institutions to sell low-yielding loans and defer the losses as a way of strengthening balance sheets. And the regulators encouraged acquirers of failed institutions to use goodwill to reduce FSLIC resolution costs.

Business decisions with long-term consequences were made on the basis of RAP accounting. Sufficient time must be provided to adjust to a new accounting regimen.

Q.9. In response to a question from Senator Sarbanes, you and Mr. Seaton testified that a range of activities are so risky that they should not be permitted at all for federally insured depository institutions. What activities do you have in mind? Please be as specific as possible.

A.9. Rather than submit a laundry list of activities, which we have not developed, we suggest that the federal regulator determine which activities are risky.

We are not advocating that federally insured institutions be precluded from engaging in risky activities. Instead, we believe the risk to the insurance fund can be minimized by requiring an institution to hold higher capital against those activities.

Q.10. I have proposed that the powers of federally insured State thrift institutions be limited to those permissible for Federal savings and loan associations. What steps should Congress take to ensure that Federal deposit insurance is not granted to State institutions that engage in risky activity?

A.10. Unless there is a strong supervisory and examination system in place, any depository institution, whether state or federally chartered, can get into difficulty exercising virtually any investment power. Commercial real estate loans -- a permitted investment for both state and federally chartered institutions -- were responsible for most of the losses in Texas, for example.

In designing a system to control the risks posed to the insurance fund by nontraditional investments, it is important to note that most of the innovative products and services banks and savings institutions offer today originated at the state level. The ability of states to innovate in the financial services area must be preserved.

We believe that the protection of the insurance fund that you are seeking can best be achieved by requiring an institution engaging in risky activities to post higher capital. The degree of risk of an activity -- and the resulting capital requirement -- should be determined by the insurer. There should not be an outright ban on insurance for state chartered institutions exercising powers beyond those available to federally chartered savings institutions.

Q.11. You concluded your opening remarks by declaring that "[a]bove all, Mr. Chairman, justice must prevail." Later, in response to a question from me, you contended that commercial banks should pay for the thrift industry's problems through a fiscal merger of the deposit insurance funds. Is that just?

A.11. What we are suggesting is the commingling of future premiums paid to the FDIC by banks and savings institutions. We are specifically suggesting that the existing $14 billion in the FDIC fund be set aside as a secondary reserve for future bank failures.

As I also said in my testimony: "The bankers act as if the fees they pay for insurance continues [sic] to belong to them. They want these premiums segregated into an essentially idle fund when they might be employed usefully today to help solve a pressing national problem and to cut down on the amount the taxpayer has to come up with. They make these demands at the same time the taxpayer is paying billions to the World Bank and the International Monetary Fund to insulate money center banks (and, by extension, the FDIC) from the consequences of uncollectable loans to third-world countries" (emphasis added).

Q.12. Would the League support removing supervision and enforcement functions from the Federal Home Loan Banks if the Home Loan Banks' members were to retain their current authority to elect the banks' directors?

A.12. No. We believe that to properly supervise institutions it is sufficient to require, as the bill does, that the chief supervisor in each of the district banks report to the chief supervisor of the Federal Home Loan Bank System.

Since the district banks' boards of directors would have responsibility only over the district banks' financial functions, and not in the supervisory and enforcement area, there is no reason to dilute the representation of the savings institutions business on the boards of directors.

Q.13. You stated that "[a]s of mid-1988 just 25 badly insolvent companies accounted for roughly one-half of the negative GAAP capital of those firms that have failed [and] . . . that more than one-half of these 25 problem cases were newly chartered or experienced a change in control in the early 1980s. In other words, with the consent of federal regulators, new and imprudent owners took over and ran these firms in a nontraditional manner."

Q.13(a). Should the deposit insurer, because it is ultimately liable, have a greater role in determining who can charter or acquire a federally insured thrift institution?

A.13(a). We believe that it is unnecessary to give the insurer greater powers over savings institutions than it exercises over national banks. Therefore, we are opposed to the provisions of the bill that would allow the FDIC to veto new chartering of savings institutions and override the Bank System's rulemaking. We would have no objection to the FDIC commenting in advance on charter applications for banks or savings institutions.

Q.13(b). Should the change-in-control laws be strengthened?

A.13(b). We believe that the current Bank Board is properly screening potential acquirers of savings institutions to keep the crooks and highfliers out of our business. If the change-of-control rules are properly administered, there should be no reason to change them.

Q.14. You contend that assessing insurance premiums on foreign deposits "would produce $4.6 billion in added revenues over the next 10 years." What is your response to the Administration's concern that assessing premiums on foreign deposits would make U.S. banks uncompetitive internationally?

A.14. We wish the administration had as much concern over the competitive disadvantage savings institutions at home have been experiencing since 1985 and will continue to experience indefinitely because of the higher premiums they will pay compared to banks.

We find it difficult to believe that a 15 basis point insurance fee on foreign deposits will put U.S. banks at a competitive disadvantage internationally. The administration has produced no evidence to back up its assertion.

Extending the insurance premium to foreign deposits would produce additional revenue for the insurance fund, and the inequity of the insurance fund protecting foreign deposits on which no insurance premium has been paid would be corrected.

National Council of Savings Institutions
Charles John Koch
Chairman

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
CHARLES JOHN KOCH

March 10, 1989

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter is in response to the two questions you raised during the Committee's hearing on March 7.

Question #1: If the Qualified Thrift Lender (QTL) test is increased to 70 percent of assets, what other 30 percent of assets should constitute the "wraparound" powers for savings and loans?

Your question strikes at the very core of the debate today: How to assure that the thrift industry going forward serves its public purpose and does not experience future losses that will burden the federal deposit insurance funds and the taxpaying public. The role of savings and loans has evolved to providing a full range of financial services to consumers and communities. While mortgage lending is the bedrock of savings and loan operations, it cannot remain the primary function going forward.

Savings and loans will continue to play an essential role in the mortgage delivery system of this Nation. However, we are very concerned that a narrow definition of QTL requirements that does not account for a broad range of community-based lending will exchange the problems of the late 1980s with the problems of the late 1970s -- that is, thrifts lending long and borrowing short, resulting in money-losing portfolios.

Over the past ten years, the Congress has worked effectively to make mortgages more attractive investments to a broader number of investors. The regulations implementing the Employee Retirement Income Security Act of 1974 have been amended to encourage pension fund investment in mortgages; laws regarding withholding on foreign portfolio investors have been amended to encourage foreign investment in mortgage-backed securities; and tax laws have been changed to allow multiple maturity mortgage-backed securities (Real Estate Mortgage Investment Conduits) that made mortgages more attractive, not only to thrifts, but also to commercial banks, pension funds,

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mutual funds, and other institutional investors, both domestic and foreign. In addition, the federal secondary market agencies, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, have had mortgage purchase limits indexed to rising home prices, which have made more expensive housing eligible for purchase by these government agencies.

The cumulative result of this activity has made our mortgage markets very efficient. Mortgages and mortgage-related securities trade like commodities, and historical spreads of mortgages over comparable maturity Treasury securities have continually diminished.

The National Council has consistently supported all the changes previously mentioned, and the homebuyer and the economy in general have benefitted greatly. Due to the efficiency in mortgage markets, we are concerned that a blanket test, applied year-in and year-out, in strong and weak real estate markets across the Nation, will force some savings and loans into making very bad business decisions in order to be in compliance with a new QTL test.

For instance, in 1986, fixed-rate mortgages fell to single digits. Adjustable rate mortgages (ARMs) were not a viable market option, and indeed the percentage of ARMs originated fell dramatically. Thrift institutions saw mortgages yielding over 12 percent refinanced into single digit loans, and ARMs refinanced into fixed rate loans. Had lenders been forced to maintain an inordinate percentage of their portfolios in mortgages during that time, even more of them would have been hurt by the steady rise in rates of the last two years.

The Administration's proposed 60 percent QTL test will not present the management difficulties that an even higher test would. A rigid test simply will not enable savings and loans to meet the complex task of asset/liability management over the cycles in interest rates and local real estate environments that come and go.

For some institutions in some markets, a 70 percent QTL test will present no problem, but that cannot be said for all institutions. Not only will an excessively rigid charter present future problems for some institutions operating as thrifts, it will create a disincentive for new investors to enter the business.

Our approach to the so-called wraparound powers is to link operating flexibility with capital. Indeed, only strong, well-capitalized thrifts should be allowed to operate. The best way to balance the needs for operating flexibility and safety and soundness going forward is to have strong capital requirements that are risk-based. This will enable the more risky, allowable activities to have capital rules that insulate the insurance fund and the taxpayer from risk.

The National Council supports the provisions of S. 413 with respect to capital deletion for subsidiaries of thrifts if the basis of comparison is the federal thrift charter and regulations, and not the national bank charter. This will enable the federal government to control the risk that non-federal institutions take and, if necessary, require a full capital deletion for the entire subsidiary investment of that thrift.

Question #2: How should the new Federal Home Loan Bank System be set up, and what should happen to the Federal Home Loan Banks?

The National Council does not oppose the provisions of S. 413 that place the new Federal Home Loan Bank System under the Department of the Treasury. We share the concerns expressed by officials including yourself, Senator Garn, and former Federal Reserve Board Chairman Paul Volcker that the new FHLBS should be an independent agency. However, we are not advocating an alternative approach to that taken in the Administration's bill.

In light of the proposed status of the FHLBS, we feel that it is important to assure greater independence on the part of the FDIC. The FDIC will emerge from the passage of this legislation with much greater power and influence over our entire financial system. The FDIC will act as the insurer of all depository institutions, and will be able to prohibit activities that are incompatible with deposit insurance. The FDIC will be responsible for setting capital standards, and will have the power to intervene and close down institutions before they become insolvent. In addition, the FDIC will have the authority to set premiums for all financial institutions.

We would recommend, as has been suggested by FDIC Chairman William Seidman, that the FDIC be granted increased independence from the Administration.

Our concerns with the future treatment of the Federal Home Loan Bank System lie more in its financial viability than in its relationship with other government entities. The provisions of S. 413 that proscribe future financial commitments of the Federal Home Loan Banks to the FSLIC problem may cripple the System.

The Federal Home Loan Banks provide advances to member institutions that purchase stock in the banks. This stock represents a cost of membership in the System. In addition, an institution securing advances must meet purchase stock requirements.

The advances are an important tool employed by this government to support housing. Advances must be collateralized by housing-related assets, including mortgage securities and residential and income property mortgages. In addition, eligibility for advances is determined by meeting the QTL test.

The removal of the existing retained earnings of the banks may represent the prudent limit of their contribution to the FSLIC problem without seriously jeopardizing their long-term viability.

In addition, the general authority provided in S. 413 for the FDIC to borrow money from the Federal Home Loan Banks with broad discretion in establishing the terms of these loans is very disturbing. This provision definitely needs clarification.

Within the context of draining the Federal Home Loan Banks to address the FSLIC problem, we would like to raise our concern over the ramifications of substandard collateral being accepted by the Federal Home Loan banks under its recent liquidity agreement with the Federal Reserve banks.

We hope to come to you in the very near future with specific recommendations addressing our concerns about the Federal Home Loan Bank System. As we work on our suggested changes, we remain commited to keeping taxpayer support of the effort to solve the FSLIC's insolvency at a minimum.

Thank you for the opportunity to comment on these important questions.

Sincerely,

Charles John Koch
Chairman

CJK:pek

National Council of Savings Institutions

Charles John Koch
Chairman

QUESTIONS FOR MR. CHARLES JOHN KOCH
FROM SENATOR DONALD W. RIEGLE, JR.
Hearing of March 7, 1989

Q.1. Representatives of some thrift institutions contend that the Administration's proposal is intended to eliminate the thrift industry. Do you agree?

Question #1: The National Council supports the Administration's plan as the foundation for a solution to the problems caused by the large number of insolvent institutions. We are encouraged that the bill will ease the problems of the S&L industry by eliminating insolvent institutions in the marketplace in a timely fashion. By reducing the over-capacity that has been plaguing the industry and hurting S&L profitability, the bill will help restore safety, soundness, and confidence to the marketplace. Clearly we do not think the intent of the bill was, nor will the likely outcome be, to eliminate the thrift industry.

Considering the condition of the industry, the current economic environment, and the costs imposed on the industry by many provisions of this bill, however, the National Council urges Congress to adopt some improvements that we feel will make the plan more workable, enhance its likelihood of achieving the desired goals, and reduce the ultimate cost to the taxpayer. We believe it is essential to do more to attract additional private capital into the savings and loan industry if the expenditure of taxpayer funds is to be kept to a minimum.

Q.2. Why should there be a separately regulated thrift industry? What purpose does it serve?

Question #2: Your question asks about the need for, and viability of, a separately regulated thrift industry. If you are asking whether there will be specialized housing finance institutions in the future, the answer is yes. Institutions can and will choose to specialize in housing-oriented products. This specialization, however, should not be dictated by the government. Excessive government control failed to provide the needed flexibility prior to the high interest rate periods of the early 1980s and, in part, contributed to the current problem.

Today's financial institutions are operating in a highly competitive and innovative marketplace. While many institutions will choose to specialize in housing finance, many others will choose to be broader-based community- and consumer-oriented financial service institutions. Residential mortgages will be only one -- albeit a very important one -- of many financial services available from these savings institutions.

A return to restrictive regulation is not the answer, nor was deregulation without proper supervision. The goal must be to establish a safe and sound financial services industry where specialization responds to market demands.

Q.3. Do you believe that thrift institutions can and will continue to be viable as portfolio lenders?

Question #3: Many thrift institutions will continue to be viable as portfolio lenders, and, indeed, the Nation's housing needs require thrift institutions to make their portfolios available to mortgages. It is important to note, however, that portfolio management is a very complex task, and great expertise is required. It would be incorrect to assume that simply requiring a large percentage of mortgage assets can remove the possibility of asset mismanagement.

Much has been said of the increasing role that mortgage-backed securities are playing in today's mortgage markets. These securities are growing and will continue to do so. However, the further development of these securities does not minimize the need for a thrift industry with significant holdings of mortgages and mortgage-related securities.

Not all mortgages and borrowers will be able to fit into the cookie-cutter approach required by the securities markets. It is likely that non-standard mortgages will be retained in a thrift's portfolio. In addition, it is important to remember that thrift institutions are the largest class of investors in mortgage-backed securities, and without thrifts, it will be difficult to find investors to replace them.

However, a rigid asset test will not work. Due to increasing competitive pressures in the marketplace, thrifts must have alternatives to invest in other than mortgages.

Q.4. You testified that if the Administration's bill is passed as proposed, (a) you would "recommend strongly" that investors obtain a national bank charter, rather than a thrift charter, if they desired to establish a depository institution whose primary purpose would be to make one-to-four family home mortgages," and (b) that "we are watering down the thrift charter to a point where . . . it's downright unattractive. All the things that are important in the charter, that make the charter attractive today, are going to be under very serious attack." What "important" and "attractive" aspects of the thrift charter are in danger of being lost?

Question #4: In order to remain profitable and healthy in today's extremely competitive financial services marketplace; provide borrowers a competitive, market rate of return on savings; and, offer mortgages at rates and fees that are the lowest possible, a thrift must be able to choose from a menu of investment opportunities, such as those provided in the Garn-St Germain Act of 1982.

My response at the hearing that raised this question arose from concerns that all the investment powers granted thrifts in 1982 would be wiped out. This rolling back of powers would come at a time when thrifts will not only continue to operate in a highly competetive marketplace, but will also have to pay the highest premiums in the history of the industry, and relatively higher premiums than commercial bank and credit union competitors.

In addition, we are concerned that one of the most stable sources of income to the industry, that of dividends from the stock in Federal Home Loan Banks, will be precipitously eroded due to provisions of the legislation. If an institution is forced to purchase FHLB stock as part of the cost of membership in the FHLB System, and the dividend paid is substandard, then this required purchase will most certainly add to the cost of operating a thrift.

The provision of the legislation that requires the capital standards of savings and loans to be "no less stringent than" those of commercial banks would suggest that future thrift capital regulations may be more onerous than those of banks. This means that it is possible that thrifts will have to hold below-market rate FHLB stock, pay higher premiums for deposit insurance than banks or credit unions, have more stringent capital standards, and have asset portfolios that are inefficiently diversified and incapable of generating attractive returns on equity.

Q.5. Under the Administration's proposal, a thrift institution could not include in its capital investments in or loans to any subsidiary that engages in activities impermissible for a national bank. You state that the National Council "supports the logic underlying this provision, but with one significant change: the comparison standards for determining which activities are permissible should be based on the federal thrift charter, as opposed to the national bank charter."

The issue, then, is what activities may be conducted in subsidiaries that are funded not with "excess capital" but with federally insured deposits.

(a) What activities are permissible for Federal savings and loan associations but not for national banks?

(b) Which of those activities do you particularly desire to conduct through deposit-funded subsidiaries?

Question #5 A. Activities that are permissible for Federal savings and loans, but not for national banks are as follows:

Real Estate Development: Federal savings and loans may perform this activity only through a service corporation (investments in service corporation limited to 2 percent of assets plus an additional 1 percent of assets for community development). A national bank may invest up to 5 percent of its assets in a bank service corporation. A bank service corporation is authorized to engage in any activity in which a bank holding company may engage. Under the bank holding company regulations, a bank holding company may make debt or equity investments in corporations or projects designed to promote community welfare by providing housing, services, or jobs.

General Insurance Agency: National banks located in towns of less than 5,000 people may act as an agent for fire, life, or other insurance. Through a bank service corporation (which may engage in activities permissible to a bank holding company), a national bank may also engage in grandfathered insurance agency activities in the state in which the principal office is located. Federal savings and loans may perform this activity (i.e., general insurance agency and brokerage activities, but not underwriting) only through a service corporation pursuant to the state insurance laws.

Investment in Corporate Debt Securities: Both a national bank and a federal savings and loan association may invest in investment grade corporate debt securities and commercial paper. Under FHLBB interpretations, federal savings and loan associations may invest in non-investment grade securities, i.e., junk bonds.

Real Estate Brokerage: Through a bank service corporation, a national bank may arrange commercial real estate equity financing. Federal savings and loans may not act as a real estate broker or agent for third parties. Through a service corporation, a federal association could act as real estate broker or agent only for properties owned by the service corporation or the parent, i.e., REO.

Appraisal for Others: A national bank may through a bank service corporation (which is authorized to engage in activities permissible for bank holding companies) perform appraisals of real and personal property for third parties. A federal savings and loan association may perform appraisals for itself. Appraisal services for others are not on the regulatory list of approved activities for service corporations.

Question #5 B. The National Council believes that the permissible activities for savings and loan subsidiaries should be determined on the basis of the capital adequacy of the institution. Institutions that meet their capital requirements should not be treated the same as institutions that do not. As you know, since the National Council testified before the Senate Banking Committee, our Board of Directors endorsed the capital timetable established in FIRREA.

Institutions must have flexibility to make management decisions on how best to serve the needs of their communities and secure an adequate return on their capital. The key element here is the presence of capital at risk, and not limitations on charters, which will limit the ability of the industry to attract new capital.

We believe that federal regulators will be able to assure safety and soundness by addressing capital standards. The proposed limitation on savings and loan subsidiary activities based on the powers of national banks is too narrow. We suggest that those activities taken on at the subsidiary level be based on those of federal savings and loans and their service corporations.

In direct response to your question, we would be particularly concerned if any activities related to real estate development, real estate brokerage (to the extent that it is authorized for federal savings and loan service corporations), or insurance brokerage were to be subject to a capital deletion.

Q.6. Why should FSLIC be separated from the Bank Board?

Question #6: The insurance and regulatory functions should be separated in order to avoid situations in which the insurance and regulatory functions will be at odds.

Q.7. One rationale for placing the Federal Home Loan Bank System under the Treasury is to break up the historically close relationship between the thrift industry and its regulator.

(a) Do you agree that that is a desirable goal?

(b) What specific suggestions do you have for ensuring that the FHLBS is truly independent of the industry?

(c) If the Federal Home Loan Bank System were independent of the Treasury, what would prevent it from being overly close to the thrift industry?

Question #7: A. The National Council believes that the regulatory functions should be free of undue influence from any source.

B. Rather than any specific statutory provisions in new legislation, strict oversight would establish a system of checks and balances that would help to ensure that future problems do not arise in this area. We support the proposal to place the FHLB System under the Treasury, but urge that the FHLBanks remain independent credit providers outside of the Treasury.

C. Again, we would suggest that effective oversight and a system of checks and balances can be the only real assurance that undue pressure is not impacting the appropriate policy.

Q.8. What possible justification would there be for permitting Federal thrift regulators to prescribe accounting standards different from those of the Federal banking agencies? Is it desirable for thrift regulators to have such authority?

Question #8: The National Council supports uniform accounting standards, and believes that a lack of uniform accounting is one reason that the FSLIC crisis has grown so large. However, we are concerned that FIRREA goes beyond comparable standards, and creates standards for thrifts in excess of those for commercial banks. Section 314 of the legislation that instructs the thrift regulator to develop capital guidelines "not less stringent than" the capital standards applicable to national banks concerns us. That language should be changed to "equivalent to," in order to make clear that banks and thrifts will operate under similar capital rules.

Q.9. You criticize the Administration's proposal as placing too great a burden on healthy thrift institutions. From what other sources should the necessary funds be raised?

Question #9: As we noted in our testimony, there are three distinct sources of funding identified in the bill: the savings industry, the private capital markets, and the taxpayer. You have heard our views on the burden being placed on the thrift industry. The taxpayers, as we also pointed out, are the ultimate source of funds, and will be forced to make up any funding short-fall.

Between these two extremes lie the capital markets -- the pool of well-capitalized investors who must be provided with realistic incentives to place their capital at risk. These are voluntary contributors who must be encouraged, but cannot be forced, to invest in and take control of savings and loan associations. If provisions in the bill discourage private investors, including healthy banks and thrifts, from investing in the industry, then the price to the taxpayer will be greater than otherwise needs to be the case.

Mr. Chairman, thank you for the opportunity to provide more input to the Committee as it works on these critical issues.

Sincerely,

Bud Koch

Charles John (Bud) Koch
Chairman

CJK:pek

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM KENNETH T. ROSEN

UNIVERSITY OF CALIFORNIA, BERKELEY

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March 31, 1989

Mr. Edward M. Malan, Editor
U.S. Senate Committee on Banking, Housing
 and Urban Affairs
Washington, D.C. 20510-6075

Dear Mr. Malan:

In response to Senator Riegle's March 14, letter with questions on the Savings and Loan crisis, I have attached a copy of Professor Rosen's testimony.

Most of the answers to your questions are in his testimony. However, I should stress that Professor Rosen believes the only justification for a separate thrift industry is the vital role the traditional industry has played for home finance. Even with the deregulation of the early 1980s, 44% of the residential mortgages were made by thrifts in 1988.

Thank you for the opportunity to present Professor Rosen's findings. Please call me if I can be of further assistance.

Sincerely,

Mary M. Corley

Mary M. Corley

Enclosure

Sanford C. Bernstein & Co., Inc.
Investment Research and Management

Jonathan E. Gray
Research Analyst

May 24, 1989

Senator Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Dear Mr. Chairman,

Please forgive the delayed response to your letter of March 14, 1989, which I failed to receive. Below please find my answers to the questions posed in your letter, to complete the hearing record.

Q. 1 Is the Administration's proposal fair or unfair?

A. 1 The Administration's proposed legislation is, for the most part fair, and would have a salutary impact on the health of our thrift institutions and our financial system if enacted. However, the proposed treatment of supervisory goodwill requires modification.

Q. 2 Concerns that stronger capital standards would cause marginal companies to fail, and thus increase the cost to FSLIC. Agree or disagree?

A. 2 The purpose of standards is to preserve the possibility of failure. The cost to FSLIC would be infinitely higher if we permitted S&Ls to continue in business without capital.

Q. 3 Is the inability of many S&Ls to raise capital an indication of overcapacity?

A. 3 Yes.

Q. 4 Are thrifts viable as portfolio lenders?

A. 4 Two thirds of the industry is and has been reasonably successful making loans on homes. The losses arose at companies that made loans on windmills under the aegis of a completely inept regulator.

Q. 5 No response.

Q. 6 Treatment of supervisory goodwill?

A. 6 The S&Ls deserve better treatment than the American Indian received from the U.S. Government. The question is...Should the United States stand behind its agreement with the acquirors of troubled institutions? Of course it should.

What if this means allowing S&Ls to operate without any tangible capital? Why doesn't the Government add to the cost of the Rescue Plan the repurchase of supervisory goodwill for cash. How can the Government recoil from the sight of accounting fictions which it encouraged?

Warmest regards,

Jonathan Gray

Jonathan E. Gray

ANSWERS TO QUESTIONS FROM SENATOR RIEGLE FOR THE RECORD OF THE SENATE BANKING COMMITTEE HEARING OF MARCH 8, 1989
AMERICAN BANKERS ASSOCIATION

1. If there is to be a separately regulated thrift industry, what purpose should it serve?

The thrift industry was created to serve as a conduit to channel consumer savings deposit funds into home mortgages. When interest rates were relatively stable and financial markets were less integrated, this system worked well. Over the past decade, however, volatile economic conditions and advancing technology have combined to create an environment in which this traditional form of borrowing and lending has become much more risky.

Congress and the regulators took the right approach to the structural problems facing the S&L industry by recognizing the need for a more flexible charter. In 1980 and again in 1982, Congress allowed limited diversification of S&L activities. Many well run thrifts have used these new powers to strengthen and diversify their portfolios. It is important to recognize that the problems facing the industry today spring not from the availability of new asset powers, but from the lack of adequate supervision and regulation.

The Administration's proposal establishes improved regulatory, supervisory, and accounting standards which will allow the thrift industry to operate safely and profitably. Under this new regulatory structure, there is no reason why thrift institutions should not continue to serve their customers as they have in the past.

2. Why would a bank holding company want to acquire a thrift institution? In answering, rank the various reasons in order of importance.

There are many similarities between operating a thrift and operating a bank, so bankers already have the skill necessary to manage an S&L. There are significant opportunities for synergies if both institutions were under the same corporate ownership. Clearly one such synergy is the ability to cross-market bank and thrift products to consumers.

Purchasing an S&L also gives banks another option in geographic diversification. For example, if a banking organization identifies a potential market it would like to serve, its current options are limited to acquisition of a bank already in the market or de novo entry. The ability to acquire an established thrift institution in the identified market adds another option which may in some circumstances be preferable to either purchasing a bank or entering the market de novo.

3. Under the Administration's proposal, a thrift institution that persistently fails the qualified thrift lender test would eventually be treated as a bank. Do you support that provision?

Yes, a thrift institution which consistently fails the QTL test should be treated as a bank.

4. Do you believe that thrift institutions should be subject to a strong qualified thrift lender test which ensures that they center their activities on housing finance?

If Congress wants to encourage greater participation in housing finance, there are two positive steps that could be taken. For example, ABA testified in favor of granting all mortgage lenders access to the FHLB advances system. In other words, access to the advances mechanism should be linked to the mortgage instrument, rather than to an institution's charter.

Equally important, Congress could restructure the tax incentives for housing finance so that all lenders qualify on a proportional basis. For example, an institution with 60 percent of its assets in mortgages would get twice as much credit as an institution with 30 percent of its assets in mortgages.

Each of these proposals -- granting equal access to the FHLB advances to all mortgage lenders, and restructuring the tax incentives for mortgage lending to include all lenders on a proportional basis -- would be an effective way to encourage increased participation in housing finance.

5. Would it be accurate to describe the thrift industry as having grown excessively? Why?

Over the past decade, the thrift industry grew at an average annual rate of 12 percent. The banking industry grew somewhat more slowly, averaging about 7 percent per year. But it is not the growth of the S&L industry per se that is responsible for the current crisis -- it is growth without adequate capital, without adequate supervision and regulation, and without an adequate closure policy which led to the FSLIC insolvency.

The growth rate of insolvent thrift institutions was significantly greater than the growth rate of solvent institutions, reflecting the fact that without capital at risk, there are strong incentives to attempt to "grow" out of insolvency. It was regulatory failure which allowed these insolvent thrifts to continue their rapid growth -- and which allowed the FSLIC's losses to mount at a staggering rate.

6. Some thrift institutions contend that the thrift industry's problems are largely the result of adverse economic conditions, such as a regional depression in the Southwest (a) Do you agree? (b) How significant have mismanagement, overcapacity, and capital forbearance been in creating the industry's problems?

The economic problems experienced in the southwest clearly contributed to a number of thrift failures, as well as the failure of many banks. But you need only look at the geographic distribution of thrift failures to see that the thrift problem goes well beyond regional economic difficulties. There are troubled thrift institutions in all areas of the country, including areas which have healthy economies.

The primary cause of the thrift crisis is regulatory failure. Throughout the 1970s and early 1980s, the net worth requirements of the thrift industry were virtually dismantled. To make matters worse, those institutions which were unable to meet the watered down net worth standards were granted "forbearance" -- leaving the industry free of any meaningful capital constraints on asset and deposit growth. Supervision and regulation were inadequate to respond to the challenges facing the thrift industry in the early 1980s. And the inability or unwillingness to promptly close insolvent institutions allowed time for these institutions to compound the extent of their insolvencies.

7. Many thrift institutions in the Southwest contend (a) that they cannot possibly raise enough capital to comply with the 1991 deadline, and (b) that they could not substantially increase their capital ratios if they were prohibited from growing. Do you agree?

The answer to question 8 outlines ABA's position on the subject of the need for adequate thrift capital. We do not have sufficient institution-specific information to discuss individual situations.

8. The Administration's proposal would prohibit thrift institutions from growing after June 1, 1991 unless they meet bank-type capital standards.

- (a) **Will the requirement cause many marginally healthy thrift institutions to fail?**
- (b) **Is the requirement unduly stringent?**
- (c) **In the long run, are the losses to the deposit insurance fund likely to be higher -- or lower -- under the Administration's proposal than they would be if institutions had more time to meet the higher capital standards (e.g., if an institution that could show that it was profitable and that its capital was increasing)?**

S&L capital standards must be brought up to those imposed on banks. Capital is the first line of defense against insolvency -- it is a buffer to absorb losses, protecting the institution, the insurance fund, and ultimately, the tax payers. The crisis we face today is largely the result of allowing institutions with no real capital at risk to continue to operate and grow. To again give in to the S&L industry's pleas for weaker capital standards would be to repeat the mistakes of the past.

Some S&Ls argue that the time frame for meeting the proposed capital standards is too short and they have asked for more time to comply. We believe this would be a serious mistake.

We recognize that meeting the proposed capital standards will be difficult for some S&Ls, but fears of massive failures are exaggerated. S&Ls which do not meet required capital standards by 1991 will not simply be put out of business. However, S&Ls without adequate capital to support their existing portfolios should not be permitted to grow. If we have learned anything from the current FSLIC crisis, it is that growth without real capital is very dangerous.

If regulators find an S&L's capital to be unacceptably low, they may require it to reduce dividends, sell assets, limit the growth of deposits, restrict loans or eventually, to merge with a healthy institution which can supply additional capital. These are the same measures a bank faces today if it does not have adequate capital.

An undercapitalized institution which honestly intends to become viable again can take some or all of the steps above. The following examples describe the actions taken by three banks whose capital levels had fallen to unacceptable levels.

- American National Bank, Mount Pleasant, Texas raised its capital from 3.4 to 7.1 percent of assets by issuing restricted stock. The bank has subsequently sold loans to shrink its assets to $15 million. An employee stock ownership plan is being considered to further enhance capital.
- Bay Area Bank & Trust Company, Webster, Texas raised its capital from 4.1 to 8.4 percent of assets through a $1 million infusion from the majority owner. BAB&TC sold securities and reduced its loans to shrink its total assets from $97 million to $63 million. The bank also reduced its deposits by $32 million.
- Iraan State Bank, Iraan, Texas raised its capital from 4.2 to 6.9 percent of assets by selling $3 million of loans to reduce its assets to $17 million. ISB also cut expenses, including interest offered on non-local deposits; deposits declined by $1 million.

Each of these institutions rebuilt its capital to meet regulatory standards in less than two years -- and they did it despite operating in the depressed Texas economy.

9. Is it desirable for a regulator of federally insured depository institutions to act as an advocate for and promoter of those institutions?

Part of the blame for the inadequate the supervision and regulation of the S&L industry lies in the legal structure of the Federal Home Loan Bank System itself -- that is, by the statutory "mandate" to promote home ownership through home financing. The FHLBB apparently interpreted that mandate as an obligation to be the S&L industry's advocate with Congress and the public. This interpretation of its role with respect to the industry led the Bank Board to acquiesce to industry pleas for weakened capital standards, for forbearance, and for less than rigorous examination and supervision.

The statutory mandate of the FHLBB should be revised so that its regulatory role is focused solely on ensuring the safe and sound operation of the institutions under its jurisdiction. Any statutory language promoting housing should be confined to the advances program of the FHLB System.

10. What possible justification would there be for permitting Federal thrift regulators to prescribe accounting standards different from those of the Federal banking agencies? Is it desirable for thrift regulators to have such authority?

There can be no justification for allowing thrift institutions to operate under accounting standards less stringent than those imposed on banks. As was stated in our testimony before your Committee, the concessions in accounting standards granted to the thrift industry in 1980 - 81 served to mask the growing number of insolvencies that were painfully obvious under generally acceptable accounting principles (GAAP) or under a tangible capital basis. Inadequate accounting standards enabled FSLIC-insured institutions to show that they had capital when in fact they did not.

The use of regulatory accounting standards (RAP) was intended to allow S&Ls time to recover from the the 1979-81 upswing in interest rates. But allowing insolvent institutions to continue to operate with "phantom" capital is in large part responsible for the current crisis. Strong capital and adequate accounting standards are vital ingredients in any responsible regulatory structure.

11. Some bankers argue that a bank holding company would have a much stronger incentive to acquire a troubled thrift institution if the thrift institution and its service-corporation subsidiaries were not restricted to the activities permissible under section 4(c)(8) of the Bank Holding Company Act. What powers currently permissible for thrift institutions or service corporations would be most attractive to prospective bank holding company acquirers?

There is no one simple answer to the question of which thrift activities would be most attractive to bank holding companies. As you know, ABA believes allowing banking organizations to offer an expanded menu of financial products and services will benefit both consumers and the industry. But that does not mean that each bank would choose to offer the same products and services. Each bank will evaluate its own particular circumstances to determine which products are best suited to its market and its business plan. For example, many community banks may be interested in selling insurance -- but they are probably not interested underwriting insurance products. In the securities area, large banks may be interested in underwriting corporate debt and equities, while smaller institutions may be more interested in underwriting municipal revenue bonds.

12. What are your views on Congressman Barnard's proposed Real Estate Appraisal Reform Act?

The ABA supports Congressman Bernard's effort to reform the real estate appraisal system. As you know, Congressman Bernard proposes to develop a uniform system of real estate appraisal standards and create a uniform mechanism for certifying real estate appraisers. The private sector real estate Appraisal Foundation, of which ABA is a member, would have input on the appraisal standards and appraiser certification requirements. The establishment of fair and reasonable appraisal standards will ultimately benefit the entire financial services industry.

ANSWER FOR SENATOR HEINTZ FOR THE RECORD
OF THE SENATE BANKING COMMITTEE HEARING OF MARCH 8, 1989
AMERICAN BANKERS ASSOCIATION

1. If there is a single message that is clear from the savings and loan crisis, it is that the United States government has placed its full faith and credit behind insured deposits. The President's plan is ample evidence that our government is putting its money where its mouth is.

I realize that the logo issue is sensitive to both the banking and thrift industries. However, I am interested to know whether you believe that depositors have confidence in the safety of insured deposits because the FDIC has 83 cents standing behind each $100 of insured bank deposits, or because the U.S. Treasury is prepared to protect depositors dollar for dollar?

The Federal Deposit Insurance Corporation reserve fund is clearly one of the components on which depositor confidence rests -- but it is by no means the only component. Bank depositors have confidence in the safety of their funds because they have faith in the strength of the banking system itself. This faith is based on the banking industry's strong capital position, sound accounting practices, responsible supervision and examination, and tough regulatory standards. If a threat to the safety and soundness of a bank is detected, corrective actions are promptly initiated. Insolvent banks are closed and liquidated or reorganized as quickly as possible.

In short, the entire bank regulatory structure assures depositors that the banking industry is healthy, adequately capitalized, well managed and fundamentally sound. In fact, the differences between bank and thrift regulatory treatment explains in large part why the FDIC is solvent and the FSLIC is not -- and why bank depositors remain confident, while thrift depositors need reassurance.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM
O. JOY TOMSON

Q. 1. If there is a single message that is clear from the savings and loan crisis, it is that the United States government has placed its full faith and credit behind insured deposits. The President's plan is ample evidence that our government is putting its money where its mouth is.

I realize that the logo issue is sensitive to both the banking and thrift industries. However, I am interested to know whether you believe that depositors have confidence in the safety of insured deposits because the FDIC has 83 cents standing behind each $100 of insured bank deposits, or because the U.S. Treasury is prepared to protect depositors dollar for dollar?

A. The Independent Bankers Association of America (IBAA) believe that the average consumer would have no substantive knowledge of the FDIC's coverage ratio. We believe that depositors' confidence is based on the government backing of the individual deposit insurance funds, which has been made explicit over the recent years by Congressional resolutions stating the full faith and credit of the government backs the funds.

The FDIC, FSLIC and NCUSIF logos each signify to consumers that a government agency is protecting their deposits. In as much as the three industries remain separate in function, with one serving the small saver, one the home owner and the other the commercial banks, IBAA feels there is merit in identifying the distinctness of each industry with a separate logo.

The IBAA is appreciative of Senator Heinz's sensitivity to the logo issue. We recognize that appropriate labeling of the thrift insurance fund is an important part of this package. We share your concern and that of the Administration that it is essential to restore full confidence in the thrifts' insurance fund and that the right label will help achieve this goal. Short of giving up the "FDIC" logo, the IBAA will support a label for the thrift insurance fund which states that thrift deposits are federally insured. In this regard, we like the suggestion offered by Senator Roth (R-DE) which would have the thrift logo state that they are insured by an agency of the Federal Government. Another idea, which we support, was recently suggested by Representative Barnard (D-GA) who proposed that Congress maintain separate FDIC and FSLIC decals and add to both decals the statement "Supported by the Full Faith and Credit of the U.S. Government."

The IBAA believes that depositor confidence is strengthened by the knowledge that the U.S. government stands behind the insurance funds. However, we do not believe that all depositors are protected to the same extent by this government safety net and this differentiation has a negative effect on consumer confidence. We have a two-tiered banking system in this country where large money center banks are considered too-big-to-fail and small community banks are considered too-small-to-save. Where a deposit is made determines whether or not depositors are protected dollar for dollar. Depositors have lost money in some small bank failures while no depositor has ever lost money in a large bank failure. We believe that depositor confidence would be improved if this inequitable situation of having two classes of banks was abolished.

QUESTIONS FOR MR. FRANK E. McKINNEY
FROM SENATOR DONALD W. RIEGLE, JR.
Hearing of March 9, 1989

Q. 1. Why would a bank holding company want to acquire a thrift institution? In answering, rank the various reasons in order of importance.

A. Bank holding companies would like to acquire thrifts for a number of reasons including the value of the thrift charter, acquisition of the network of existing branches and the more liberal branching rights that thrifts often possess, also the expanded opportunities that banks would be afforded with respect to products and services including the opportunities provided by thrift service corporations are very significant. While it would be difficult to list the foregoing in order of importance, the enhanced products and services that owning a thrift would afford bank holding companies would be the most important — and it is regrettable such authority is denied bank holding companies in S.774.

Q. 2. Under the Administration's proposal, a thrift institution that persistently fails the qualified thrift lender test would eventually be treated as a bank. Do you support that provision?

A. If the primary purpose of a thrift is to be a home mortgage lender, then if an institution does not meet this primary purpose it should not be a thrift. We would not object to treating such nonthrifts as banks if they are subject to bank capital, accounting and supervisory standards.

Q. 3. Do you believe that thrift institutions should be subject to a strong qualified thrift lender test which ensures that they center their activities on housing finance?

A. As noted in the previous answer, if the primary purpose of thrifts is to finance home mortgage loans, then they should be subject to a legitimate qualified thrift lender test that ensures they will center their activities on housing finance, but the test should not be so severe as to impair survival.

Q. 4. Some thrift institutions contend that the thrift industry's problems are largely the result of adverse economic conditions, such as a regional depression in the Southwest.

(a) Do you agree?

(b) How significant have mismanagement, overcapacity, and capital forbearance been in creating the industry's problems?

A. While adverse economic conditions undoubtedly contributed to thrift industry problems, just as they have contributed to problems in the commercial banking industry, we do not agree that such was the principal cause of failure. We believe that mismanagement, overcapacity, and regulatory forbearance were more significant factors. Studies of thrift failures that we have seen confirm this viewpoint. Adverse economic conditions merely exposed and compounded preexisting weaknesses in the thrift industry.

Q. 5. Many thrift institutions in the southwest contend (a) that they cannot possibly raise enough capital to comply with the 1991 deadline, and (b) that they could not substantially increase their capital ratios if they were prohibited from growing. Do you agree?

A. We believe that an institution that has impaired capital should not be allowed to grow until it meets capital standards. We do not agree that the failure to allow capital impaired institutions to grow will prevent such institutions from increasing their capital ratios. As a matter of fact, if memory serves us correctly the FDIC put growth constraints on the mutual savings banks in New York State, in the early 80's, and this did not prevent these banks from eventually meeting capital standards. In fact, it aided them.

Q. 6. The Administration's proposal would prohibit thrift institutions from growing after June 1, 1991 unless they meet bank-type capital standards.

(a) Will the requirement cause many marginally healthy thrift institutions to fail?

(b) Is the requirement unduly stringent?

(c) In the long run, are the losses to the deposit insurance fund likely to be higher — or lower — under the Administration's proposal than they would be if institutions had more time to meet the higher capital standards (e.g., if an institution that would show that it was profitable and that its capital was increasing)?

A. The best way to lessen long term losses to the Federal deposit insurance funds is to insist on adequate capital for insured institutions at the earliest possible date. It is sheer nonsense to suggest that an institution with impaired capital should be allowed to exist in such a condition for an extended time. If the current thrift crisis has taught us anything, it should have taught us that the longer an institution with impaired capital is permitted to remain open for business without supervisory constraints, the greater the ultimate loss to the deposit insurance fund is going to be. Under the circumstances, thrifts with impaired capital should be required to get up to adequate capital standards at the earliest possible date, thus lessening long term — and ever increasing losses — to the deposit insurance fund.

Q. 7. Is it desirable for a regulator of federally insured depository institutions to act as an advocate for and promoter of those institutions?

A. It is not desirable for a regulator of federally insured depository institutions to act as an advocate for and promoter of those institutions. The word "regulator" implies close scrutiny and tough oversight, roles which are inconsistent with the role of a cheerleader.

Q. 8. What possible justification would there be for permitting Federal thrift regulators to prescribe accounting standards different from those of the Federal banking agencies? Is it desirable for thrift regulators to have such authority?

A. Equity and parity dictate that financial institutions should be subject to similar and consistent accounting standards. No regulator should have the authority to do otherwise. No regulator should have the statutory authority to allow a financial institution to "cook the books" as the Bank Board allowed the thrifts to do. The resulting debacle suffered by the thrift industry is justification enough for not allowing similar happenings in the future.

Q. 9. You suggested that a bank holding company would have a much stronger incentive to acquire a troubled thrift institution if the thrift institution and its service-corporation subsidiaries were not restricted to the activities permissible under section 4(c)(8) of the Bank Holding Company Act. What powers currently permissible for thrift institutions or service corporations would be most attractive to prospective bank holding company acquirers?

A. With the acquisition of thrift institutions and their service corporation bank holding companies would be primarily interested in expanding the scope of their permissible activities in traditional financial services areas. Thus, bank holding companies would be interested in retail activities such as insurance and real estate brokerage.

Q. 10. What are your views on Congressman Barnard's proposed Real Estate Appraisal Reform Act?

A. We have not fashioned an opinion on Congressman Doug Barnard's proposed Real Estate Appraisal Reform Act, but we would certainly not oppose it.

ASSOCIATION OF THRIFT HOLDING COMPANIES
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BY HAND

April 7, 1989

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear Senator Riegle:

The Association of Thrift Holding Companies appreciates the opportunity to respond to the questions raised in your letter of March 16, 1989 relating to our testimony before the Committee on S.413, the "Financial Institutions Reform, Recovery and Enforcement Act of 1989." We have responded to those questions on which we believe we can make a contribution. Your questions, and then responses are set out below.

Q.1. Taken as a whole, is the Administration's proposed legislation (S.413) fair or unfair to the thrift industry?

As a whole, we believe that the Administration bill is fair to the thrift industry in that it taps the resources of the industry to pay a substantial portion of the cost of recovery before using taxpayer funds. One of the most difficult issues presented by the recovery program is the development of a formula that does not weaken the healthy segment of the industry nor stifle the recovery of marginally healthy thrifts that have the ability to recover. The key to recovery is the ability of the thrift industry to attract capital. The bill has several provisions that remove barriers to raising capital and other proposals that impair thrifts' ability to raise capital. We have discussed these issues in our testimony and have proposed amendments that address proposals that impede the flow of capital to the thrift industry.

Q.2. Representatives of some thrift institutions contend that the Administration's proposal is intended to eliminate the thrift industry. Do you agree?

We do not believe that the Administration's proposal is intended to eliminate the thrift industry. It is designed to restore the industry to a sound financial condition by removal of failing thrifts, preserving assets that are salvageable, and reorganizing the regulatory structure of the industry to prevent a recurrence of the current crisis.

The value of the thrift charter would be drastically reduced, however, by the proposal that an S&L reduce its capital by the amount of its equity investments in, and loans to, a subsidiary engaged in activities not permissible for a national bank. This proposal is nothing less than a de facto prohibition against an S&L engaging in these activities since the economic incentive to do so would be reduced to zero.

This proposal would also be a substantial disincentive to potential acquirors of, or investors in, a thrift institution because it deprives the thrift of activities that make its charter unique. If this proposal were enacted, thrift institutions would become "second class" national banks since the activities of thrift subsidiaries would be limited to those of national banks but the thrifts' deposit insurance premiums would be higher than those of national banks. We urge the deletion of this proposal from the bill.

Q.3. If there is to be a separately regulated thrift industry, what purpose should it serve?

We believe that a separately regulated thrift industry is essential to the maintenance of the vitality and competitive nature of today's financial services marketplace. Many non-traditional providers of banking services have entered this marketplace to compete with banks and thrift institutions. The resulting competition has been good for the consumer and for the thrift and banking industries. The thrift industry, however, has a long-standing relationship with most of its customers as well as considerable expertise in providing consumer services. We believe that a well-capitalized thrift industry providing a stable and continuing source of funds for housing finance and other consumer needs will ensure that the consumer continues to have the widest possible choice of financial services.

In addition, demand for mortgage loans fluctuates with interest rates and other economic factors and we believe that some non-traditional mortgage lenders may stop offering mortgages during times of low demand. The thrift industry is a repository of experience in mortgage origination and servicing and we do not believe it likely that the thrift industry, because of this expertise and its traditional commitment to home finance, will abandon the mortgage market when demand is low.

In addition, of course, the qualified thrift lender (QTL) test and the tax code provide substantial incentives to remain in the mortgage market. Mortgage loan demand does fluctuate, however, and intense competition for mortgage origination exists in many markets. The QTL test should be amended to accommodate these factors. The price of the continuation of the thrift industry should not be a test that forces institutions in that industry to write mortgage loans at a loss in order to remain a part of that industry.

Q.4. Some thrift institutions contend that the thrift industry's problems are largely the result of adverse economic conditions, such as a regional depression in the Southwest.

(a) Do you agree?

We believe that the conditions leading to the thrift crisis began with the high interest rates of the late 1970s and the early 1980s. Interest rate controls on savings accounts were gradually removed during this period so that the S&Ls were able to compete with money market funds for savings. In a short time, however, the cost of deposits exceeded the return on these institution's portfolios of fixed-rate mortgage loans. As this imbalance began to erode the capital of the S&L industry, regulators lowered capital standards, increased forbearances and issued regulatory accounting rules that concealed the economic impact of the negative spreads in the industry. These developments, coupled with a deteriorating quality of supervision and enforcement resulted in many GAAP-insolvent institutions remaining open when they should have been closed.

In the Southwest, these conditions were exacerbated by the decline in the price of oil and the depression of the regional economy. In a stable interest rate environment, the depression in the Southwest would have undoubtedly resulted in S&L failures, but we believe that this economic depression alone would not have precipitated a national crisis.

(b) How significant have mismanagement, overcapacity, and capital forbearance been in creating the industry's problems?

With adequate supervision, officials who were clearly incapable of managing a thrift would have been more quickly detected and either removed or subjected to supervisory restraints. Overcapacity could also have been remedied more quickly. Capital forbearance during a period of widespread capital erosion contributed to the crisis by concealing the true economic condition of failing S&Ls and permitted the losses of the institutions to grow.

Q.5. You strongly argue that thrift institutions should be made "subject to the uniform risk-based capital standards developed in accordance with the Basel Accord" -- instead of having separate capital standards "not less stringent" than those applicable to national banks.

(a) Some thrift industry representatives argue that thrift institutions cannot realistically be expected to meet bank-like capital standards by 1991. Yet you express a willingness to accept bank capital standards (as long as you can amortize most goodwill over 10 years and supervisory goodwill over a longer period), and you do not complain about the 1991 date. Please elaborate on why you are willing to accept those standards.

Our members can meet the standards adopted in the Basel Accord by the June 1, 1991 date.

(b) Some thrift representatives argue that the Basel Accord standards are designed for large commercial banks and cannot be applied to thrift institutions without modification. You evidently disagree. Explain why.

We believe that the fundamental principles embodied in the Basel Accord relating to the definition of capital and the assignment of risk weights to various categories of assets are valid measures of the capital adequacy of thrift institutions. The Accord covers many assets and transactions which are not applicable to thrifts, but this fact does not affect the validity of the underlying concepts of the Accord.

(c) The Basel Accord standards focus on credit risk, rather than interest-rate risk. How would you control the interest-rate risk to which thrift institutions are exposed?

(d) Do you agree that thrift institutions should be subject to the same accounting standards as banks?

We believe that thrifts and banks should both be subject to GAAP immediately. Legislation to this effect would help restore the confidence of the public and the capital markets in the thrift industry.

Q.6. Under the Administration's proposal, a thrift institution could not include in its capital investments in or loans to any subsidiary that engages in activities impermissible for a national bank. You object to that provision. The issue, as I see it, is what activities a thrift institution may conduct through a subsidiary that is funded not with excess capital but with federally insured deposits.

(a) What activities are permissible for Federal savings and loan associations but not for national banks? and

(b) Which of those activities do you particularly desire to conduct through deposit-funded subsidiaries?

In general, federal savings and loan associations and their subsidiaries have greater flexibility and broader powers than national banks in mortgage lending and the sale and brokerage of insurance. In addition, federal S&Ls have powers relating to real estate investment, brokerage and management through a subsidiary that most banks do not have.

We believe that these powers are not inherently unsafe and that with proper supervision and prudent management, the retention of these powers will enhance the value of the thrift charter.

Q.7. One rationale for placing the Federal Home Loan Bank System under the Treasury is to break up the historically close relationship between the thrift industry and its regulator.

(a) Do you agree that that is a desirable goal?

We believe that there should be a certain distance, or formality between a regulator and the industry that is regulated. The regulated industry should not be a "partner" with its own regulator.

(b) If the Federal Home Loan Bank System Chairman were independent of the Treasury, what would prevent that agency from being overly close to the industry?

Q.8. Is it desirable for a regulator of federally insured depository institutions to act as an advocate for and promoter of those institutions?

A regulator of insured depository institutions should represent the interests of the public in having a safe and sound banking and thrift system. The regulator should not protect the industry from the consequences of poor management or regional economic collapse. A regulator should not use "forbearance" as an excuse to postpone the enforcement of regulations, including capital standards, that relate to safe and sound operations.

Q.9. You criticize the Administration's proposal as placing too great a burden on healthy thrift institutions. From what other sources should the necessary funds be raised?

An additional source of funds would be the income from the approximately $43 billion that the Federal Reserve currently holds on an interest-free basis. We estimate that this $43 billion will generate approximately $3 - $4 Billion in interest income. These funds should reduce the contributions from retained earnings and annual earnings of the Federal Home Loan Banks that are proposed in the bill.

Q.10. You suggest that the Committee consider imposing a fee on brokered deposits. Please explain specifically what you have in mind and how it would work (including how large the fee should be, how much revenue it would raise, and how it would be collected).

Deposit brokers are the direct beneficiaries of the deposit insurance system. They earn fees by helping individuals receive deposit insurance on an unlimited amount of funds by breaking large sums into deposits of $100,000 or less. We propose that money brokers, as beneficiaries of the deposit insurance system, be assessed a fee equal to twice the deposit insurance premium on the insured deposits they place with Federally-insured depositories. This fee schedule should be reviewed by Congress after a 3 - 5 year period.

I hope the responses will be helpful to you and the Committee as you begin your deliberations on S.413. Please do not hesitate to call on us if we may provide additional information.

Sincerely,

H.M. Osteen

H. M. Osteen, Jr.
Chairman

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ANTHONY T. CLUFF
EXECUTIVE DIRECTOR

ASSOCIATION OF RESERVE CITY BANKERS

ARCB

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM CHARLES J. ZWICK

March 23, 1989

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing and Urban Affairs
534 Senate Dirksen Office Building
Washington, D. C. 20510-6075

Dear Chairman Riegle:

Enclosed are our responses to the questions you asked of Charles J. Zwick in your letter of March 16, 1989.

The Association of Reserve City Bankers appreciates very much the opportunity to present its views on the FSLIC/thrift industry crisis to the Committee.

Sincerely,

Anthony T. Cluff

Anthony T. Cluff

Enclosure

Responses to Questions from Chairman Riegle

Q.1 Why would a bank holding company want to acquire a thrift institution? In answering, rank the various reasons in order of importance.

The most important reason for a bank holding company to acquire a thrift institution would be to strengthen its competitive position in the financial services marketplace. The acquisition of a thrift could allow the bank holding company to strengthen its deposit base. It may also strengthen the holding company's stability and performance through diversification.

From a public policy perspective, the most important reason for allowing bank holding companies to acquire thrifts would be to bring new capital and managerial capabilities into the thrift industry. Both are currently in short supply.

Q.2 Under the Administration's proposal, a thrift institution that persistently fails the qualified thrift lender test would eventually be treated as a bank. Do you support that provision?

If there is going to continue to be a qualified thrift lender test, a thrift that fails to meet that test should be treated as a bank. The important question is whether or not such a test continues to be appropriate. As noted in my statement to the Committee on March 9, 1989, it was the forced specialization of thrifts as residential mortgage lenders that caused financial difficulties at many thrifts in the late 1970s and early 1980s, leading to the crisis the thrift industry faces today. For that reason, the forced specialization of the industry through a qualified thrift lender test in the future is seen as inappropriate public policy if the same difficulties thrifts faced in the past are to be avoided in the future.

If there is going to be a qualified thrift lender test, however, it should be one that is directed to the residential mortgage market and not to other areas of lending such as automobile loans, for example. Also, the favorable tax treatment and funding from Home Loan Banks extended to thrifts meeting the qualified lender test should be extended to banks that also meet that test.

The qualified thrift lender test in general, however, would be a perpetuation of public policies that caused financial turmoil in the thrift industry and should, for that reason, be discontinued.

Q.3 Do you believe that thrift institutions should be subject to a strong qualified thrift lender test which ensures that they center their activities on housing finance?

As noted in the answer to the previous question, if there is to be such a test it would seem appropriate to confine lending under that test to the housing market. But, of course, such a non-diversification of lending portfolios is a risky approach to lending, as the thrift crisis clearly illustrates. That is why it should be discontinued.

If, on the other hand, the test is a liberal one under which other types of lending, such as automobile loans, qualify, then the purpose of the test is frustrated. It would also be highly questionable to include such non-housing lending under the test because other institutions, such as banks, make those types of loans also, but they would not be afforded the favorable taxing and borrowing privileges that thrifts meeting the qualified thrift lender test would.

Q.4 Some thrift institutions contend that the thrift industry's problems are largely the result of adverse economic conditions, such as a regional depression in the Southwest. Do you agree? How significant have mismanagement, overcapacity, and capital forbearance been in creating the industry's problems?

Economic conditions certainly exacerbated problems in the thrift industry. Numerous studies, however, point to mismanagement as the primary reason for the thrift industry's problems. But, any one single cause for the crisis may never be pinpointed since the factors are interrelated. For instance, a deterioration in economic conditions may have encouraged the adoption of inappropriate management practices in a desperate attempt to keep an institution afloat.

It is fair to say that there is considerable overcapacity in the financial system today. Much of it will be wrung out of the system during the period ahead. Capital forbearance was a factor of considerable importance in creating the seriousness of the thrift crisis today. Capital forbearance allowed many institutions to remain in operation far beyond what should have otherwise occurred. The result was not only deepening losses at those institutions but an enlarged exposure for the federal government to address at a later date.

Q.5 Many thrift institutions in the Southwest contend (a) that they cannot possibly raise enough capital to comply with the 1991 deadline, and (b) that they could not substantially increase their capital ratios if they were prohibited from growing. Do you agree?

Both contentions of the thrift industry beg the issue of the need for more capital in that industry. The lack of adequate capital in the past was a major reason why many thrifts were unable to weather a change in economic conditions. Capital forbearance recognized this and attempted to deal with it by overlooking capital shortfalls, with disastrous results. The most important thing would be to set firm capital standards to be achieved within a set timetable and restrict growth of those institutions unable to meet the standards within the time allowed.

One item that would be helpful would be to continue to allow thrifts to count goodwill as capital for some reasonable period in the future. Also, bank holding companies acquiring thrifts should be allowed to count that goodwill as capital. This should continue for some reasonable period into the future. More capital is needed in the thrift industry. Bank holding companies can provide that capital, but the disallowance of goodwill will discourage thrift acquisitions by bank holding companies. Bank holding companies should be allowed to buy thrifts on the same basis, and under the same capital rules, as other nonbanking companies.

Q.6 The administration's proposai would prohibit thrift institutions from growing after June 1, 1991 unless they meet bank-type capital standards. (a) will this requirement cause many marginally healthy thrift institutions to fail? (b) is the requirement unduly stringent? (c) In the long run, are the losses to the deposit insurance fund likely to be higher--or lower--under the Administration's proposal than they would be if institutions had more time to meet the higher capital standards (e.g., if an institution that could show that it was profitable and that its capital was increasing)?

As noted above, the most important step which could be taken would be to set a firm capital standard and a fixed timetable for achieving it. Flexibility has its virtues, but the history of regulatory policy toward the thrift industry suggest that policies toward capital adequacy need to be securely in place and enforced.

Q.7 Is it desirable for a regulator of federally insured depository institutions to act as an advocate for an promoter of those institutions?

Based on the history of thrift regulation, the answer to this would be no. There is need for the regulatory agencies to be aware of the impact their decisions will have on the institutions they regulate. Consultation and communication between the regulators and the regulated is essential. It would seem that the appropriate approach would be to maintain a dynamic tension between the regulators and the regulated institutions that would recognize the legitimate interests of all parties. In the case of the thrifts, this dynamic tension was not achieved.

Q.8 What possible justification would there be for permitting Federal thrift regulators to prescribe accounting standards different from those of the Federal banking agencies? Is it desirable for thrift regulators to have such authority?

There appears to be no justification.

Q.9 You suggested that a bank holding company would have a much stronger incentive to acquire a troubled thrift institution if the thrift institution and its service-corporation subsidiaries were not restricted to the activities permissible under section 4(c)(8) of the Bank Holding Company Act. What powers currently permissible for thrift institutions or service corporations would be most attractive to prospective bank holding company acquirers?

The most attractive powers are origination and underwriting of life, health and annuity products; title insurance and escrow services; direct investment in securities of business enterprises; direct investment in financial real estate projects and property management.

Q.10 What are your views on Congressman Barnard's proposed Real Estate Appraisal Reform Act?

ARCB has not adopted a position on this legislation.

QUESTIONS FOR MR. JEROME BLANK

THE NATIONAL ASSOCIATION OF REALTORS® POSITIONS ON SENATOR RIEGLE'S FSLIC QUESTIONS

Q.1. Taken as a whole, is the Administration's proposed legislation (S. 413) fair or unfair to the thrift industry?

1. The NATIONAL ASSOCIATION OF REALTORS® believes the Administration's plan to recapitalize and reform the thrift industry is fair because it requires the thrift industry to rededicate itself to its original purpose of providing affordable housing finance. The Administration's plan should be applauded for its attempt to create a statutory and regulatory structure that will ensure the viability of the industry and against the recurrence of this type of financial debacle and its return to its original statutory mission. We cannot overemphasize that well-capitalized and well-regulated thrifts who remain faithful to their original charter are needed for the continued delivery of home mortgage finance.

Q.2. If there is to be a separately regulated thrift industry, what purpose should it serve?

2. As mentioned in the answer to question #1, a separately regulated thrift industry should provide housing finance for American homebuyers. We cannot support those institutions which want to call themselves thrifts but which are only thrifts in name only -- i.e., their activities go well beyond this traditional realm. Thrifts should not continue to enjoy federal deposit insurance without fulfilling their statutory responsibility to be a major provider of home mortgage credit.

Q.3. Do you believe that thrift institutions should be subject to a strong qualified thrift lender test which ensures that they center their activities on housing finance?

3. The NATIONAL ASSOCIATION OF REALTORS® believes thrift institutions should be subject to a strong Qualified Thrift Lender (QTL) test and we applaud the "tightened" QTL standards that have been adopted by the Senate. The current law gives QTL credit for assets that may have little to do with residential mortgage lending, while the proposed language maintains the 60% test but narrows the definition of what assets may qualify for inclusion.

Q.4. One rationale for placing the Federal Home Loan Bank System under the Treasury is to break up the historically close relationship between the thrift industry and its regulator.

(a) Do you agree that that is a desirable goal?

(b) If the Federal Home Loan Bank System Chairman were independent of the Treasury, what would prevent that agency from being overly close to the industry?

4a. The Association understands the premise underlying the Administration's proposal to put the Federal Home Loan Bank System (FHLBS) under the Department of the Treasury and is generally supportive of the proposal because of the need to maintain the independence of the regulator from the "regulated", the thrift industry. We are concerned, however, that the credit activities of the Federal Home Loan Banks remain independent of Treasury oversight under a new independent agency.

b. If the Federal Home Loan Bank System Chairman were to remain independent of the Treasury, there are potential measures which could insulate the agency from industry or political pressures, such as limitations on the number of thrift industry Board members, internal mechanisms to ensure objectivity of the Chairman and Board members such as prohibitions on ex parte communications, establishment the office of inspector general, etc.

Q.5. You testified that "Looking at the current situation makes it quite obvious that institutions' involvement in non-traditional activities such as real estate equity investment and brokerage services have indeed threatened the stability of the entire financial system and have increased taxpayer liability to countless and as yet unknown billions of dollars." Please set forth the evidence of real-estate brokerage services being a major source of loss to depository institutions.

5. The NATIONAL ASSOCIATION OF REALTORS® is currently conducting research and compiling data with regard to establishing a valid nexus between thrift institutions' involvement in real estate brokerage and losses to the FSLIC. Needless to say, the chief threat or risk to the insurance fund caused by thrifts' involvement in brokerage is one of market perception, i.e., that an individual who uses the services of a real estate affiliate will necessarily receive favorable or preferential treatment from the financial institution. This raises immediate concerns that an equitable competitive environment cannot and will not exist as between independent real estate firms and those affiliated with insured savings and loan associations.

Obviously, the relationship between thrift institutions' involvement in real estate investment and development and Losses to the insurance fund has already been supported by more concrete evidence. There are very real risks to financial institutions from direct investments in real estate activities. Real estate development is highly leveraged and the risk of poor returns on the real estate project is high because the return comes only at the time of sale. This real estate development investments contribute to the overall volatility of thrift returns. Moreover, the 'non-thrift' powers are not only risky, the returns on these investments have been poor. We have attached a list of references used for the preceding paragraph:

Barth, James R.; Brumbaugh, R. Dan; Sauerhaft, Daniel; and Wang, George H.K. "Thrift Institution Failures: Causes and Policy Issues." Research Working Paper #117, Office of Policy and Economic Research, Federal Home Loan Bank Board, Washington, D.C., 1985.

Benston, George J. "Investment by and the Failure of Savings and Loan Associations: An Analysis with Particular Concern for Direct Investments and Non-mortgage Loans." paper presented to U.S. House of Representatives, Committee on Banking, Finance, and Urban Affairs, Subcommittee on Financial Institutions, October 2, 1985.

Crockett, John; Fry, Clifford; and Horvitz, Paul. "Equity Participation in Real Estate by Savings and Loans: Implications for Profitability and Risk." American Real Estate and Urban Economics Association meetings, Washington, D.C., December, 1984.

Freund, James L., "Real Estate Investments by Thrift Service Corporations "unpublished paper prepared for the Division of Research and Statistics, Board of Governors of Federal Reserve System, Washington, D.C., April, 1986.

Q.6. What are your views on Congressman Barnard's proposed Real Estate Appraisal Reform Act?

6. The NATIONAL ASSOCIATION OF REALTORS® supports Congressman Barnard's Real Estate Reform Act amendments, incorporated as an amendment to H.R.1278 and approved by the House Banking Committee on May 16, 1989. The legislation requires each federal financial institutions regulatory agency to establish standards for the performance of real estate appraisals in accordance with the standards of the Appraisal Foundation and to determine which federally related transactions will be conducted by a state certified or licensed (depending upon the size and complexity of the transaction) appraiser.

MORTGAGE BANKERS ASSOCIATION
OF AMERICA

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM
WILLARD GOURLEY

March 28, 1989

Burton C. Wood
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The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20515

Dear Mr. Chairman:

In connection with the hearings held on March 10, 1989 regarding the Administration's proposal for addressing the thrift crisis, at which the Mortgage Bankers Association of America (MBA) testified, you submitted, by letter of March 17, 1989, a list of questions you would like answered for the hearing record. Below are MBA's responses to those questions.

1. **Taken as a whole, is the Administration's proposed legislation (S 413) fair or unfair to the thrift industry?**

MBA believes the Administration's proposal is fair to the thrift industry. The plan deals quickly and efficiently with insolvent institutions by placing them under joint FSLIC/FDIC supervisory control, and restricts asset growth of unhealthy thrifts if they fail to meet minimum standardized capital requirements, or if they are taking excessive risk.

MBA supports these changes because it means an opportunity for all mortgage lenders, including thrifts that utilize prudent practices, to do business on a more equal basis -- without the destructive pricing and lending practices of crippled competitors.

2. **If there is to be a separately regulated thrift industry, what purpose should it serve?**

MBA believes a separately regulated thrift industry should serve a two-fold purpose. First, it should continue its role as a provider of specialized, community-oriented, home mortgage financing, particularly in rural markets. Second, it should serve as a safe depository for small savers to store their earnings.

MBA
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1125 Fifteenth Street, N.W. Washington, D.C. 20005

3. **One rationale for placing the Federal Home Loan Bank System under Treasury is to break up the historically close relationship between the thrift industry and its regulator.**

   (a) Do you agree that that is a desirable goal?

   MBA believes the goals relating to any oversight scheme of the thrift industry should be to assure sound, forceful, and fair regulation, and to make certain that the industry's public purposes are being served.

   (b) If the Federal Home Loan Bank System Chairman was independent of the Treasury, what would prevent that agency from being overly close to the industry?

   MBA believes a system of regulation, similar to the Federal Reserve System, would help ensure that an arms-length relationship exists between the thrift industry and its regulator.

   Under the Federal Reserve System, the regulation of member banks is implemented through a network of twelve Federal Reserve Banks located throughout the United States. Each Reserve Bank has its own board, consisting of nine outside directors. As provided by law, three Class A directors, who represent members banks, and three Class B directors, who represent the public, are elected by the member banks in each Federal Reserve District. The Board of Governors appoints three Class C directors, who also represent the public, and it designates one of these three as chairman and another as deputy chairman of the Bank's board. No Class B or Class C director may be an officer, director, or employee of a member bank, nor may Class C directors be stockholders of a member bank.

   The prohibition against board membership for employees, directors, or stockholders of member banks provides complete autonomy in regulation. Likewise, a system of board membership for the twelve Federal Home Loan Banks, similar to that of the Federal Reserve Banks, would promote greater independence of thrift regulation.

4. **What are your views on Congressman Barnard's proposed Real Estate Appraisal Reform Act?**

   MBA supports the proposed Real Estate Appraisal Reform Act as adopted by the House Government Operations Committee during the 100th Congress. This legislation is consistent with our policy position which provides that the regulation of the appraisal industry is best accomplished via a self-regulatory organization. We believe the recognition, in this legislation, of the national, uniform appraisal standards adopted by the Appraisal Foundation, is a major step toward appropriate regulatory supervision of this industry.

* * * *

MBA would like to clarify, for the hearing record, certain statistics that were offered during the March 10 hearing, that relate to the percentage of home mortgage originations made by various types of lenders. On pages 29 and 30 of the hearing transcript, Chairman Riegle read into the record certain data, captioned "Mortgage Originations by Institution," gathered by the Department of Housing and Urban Development (HUD). Through the third quarter of 1988, the data indicated that 54 percent of the dollar volume of mortgage originations came from thrifts, 27 percent of the dollar volume came from commercial banks, 17 percent from mortgage bankers, and the remainder from very small participants. For 1987, the data read into the record indicated that 53 percent of the total dollar volume of mortgage originations were made by thrifts, 30 percent by commercial banks, 15 percent by mortgage bankers, and so forth.

Attachment A to this letter, based on information supplied by HUD, provides data which differs from this information. Attachment A indicates that through the third quarter of 1988, thrifts (which includes mutual savings banks and savings and loan associations) originated about 49 percent of the dollar volume of 1-4 family mortgage loans, commercial banks originated about 25 percent, and mortgage bankers originated about 24 percent.

Attachment B provides HUD data for 1986 and 1987. For 1987, thrifts originated 46 percent of the total dollar volume for 1-4 family mortgage loans, commercial banks originated approximately 28 percent, and mortgage bankers originated approximately 25 percent. For 1986, when interest rates were at relatively low levels, thrifts originated 46 percent, commercial banks originated about 24 percent, and mortgage bankers originated about 29 percent.

We provide this data to demonstrate that mortgage bankers have made a significant contribution in the origination of home loans, during good times and in bad, and to clarify the hearing record regarding the proper percentages of home originations by type of lender.

We would be happy to furnish any additional needed information.

Sincerely,

cc: Edward M. Malan
Editor
Senate Banking Committee

Steven B. Harris, Esq.
General Counsel
Senate Banking Committee

Enclosures

Attachment A

ORIGINATIONS OF MORTGAGE LOANS ON 1-4 FAMILY HOMES

	BILLIONS OF DOLLARS			QUARTERS 1988:I-1988:III	
	1988:I	1988:II	1988:III	$TOTAL	%SHARE
ALL LOANS:					
MORTGAGE BANKERS	17.820	23.893	25.432	67.145	23.67
SAVINGS & LOANS	28.409	44.565	47.703	120.677	42.54
MUTUAL SAVINGS BANKS	4.118	6.136	8.046	18.300	6.45
COMMERCIAL BANKS	17.531	26.900	27.788	72.219	25.46
OTHER	1.204	1.991	2.144	5.339	1.88
ALL LENDERS	69.082	103.485	111.114	283.681	100.00
CONVENTIONAL LOANS:					
MORTGAGE BANKERS	11.632	15.218	16.583	43.433	17.35
SAVINGS & LOANS	27.289	43.382	46.265	116.936	46.71
MUTUAL SAVINGS BANKS	4.085	5.897	7.823	17.805	7.11
COMMERCIAL BANKS	16.070	24.726	26.472	67.268	26.87
OTHER	1.128	1.827	1.975	4.930	1.97
ALL LENDERS	60.203	91.050	99.118	250.371	100.00
FHA LOANS:					
MORTGAGE BANKERS	4.329	6.372	6.355	17.056	71.62
SAVINGS & LOANS	.733	.849	.867	2.449	10.28
MUTUAL SAVINGS BANKS	.028	.161	.158	.347	1.46
COMMERCIAL BANKS	1.082	1.580	.981	3.643	15.30
OTHER	.058	.124	.139	.321	1.35
ALL LENDERS	6.230	9.086	8.500	23.816	100.00
VA LOANS:					
MORTGAGE BANKERS	1.859	2.303	2.494	6.656	70.11
SAVINGS & LOANS	.387	.334	.571	1.292	13.61
MUTUAL SAVINGS BANKS	.006	.079	.065	.150	1.58
COMMERCIAL BANKS	.379	.594	.335	1.308	13.78
OTHER	.018	.040	.030	.088	0.93
ALL LENDERS	2.649	3.349	3.495	9.493	100.00

Source: HUD, Survey of Mortgage Lending Activity: Third Quarter 1988
December 22, 1988

Prepared by: Thomas M. Holloway
MBA Economics Department
March 22, 1989

Attachment B

ORIGINATIONS OF MORTGAGE LOANS ON 1-4 FAMILY HOMES

	BILLIONS OF DOLLARS		MARKET SHARE [PERCENT]	
	1986	1987	1986	1987
ALL LOANS:				
MORTGAGE BANKERS	131.628	110.093	28.93	24.49
SAVINGS & LOANS	176.073	173.822	38.69	38.67
MUTUAL SAVINGS BANKS	31.109	34.232	6.84	7.61
COMMERCIAL BANKS	108.613	124.551	23.87	27.71
OTHER[1]	7.632	6.846	1.68	1.52
ALL LENDERS	455.054	449.544	-100-	-100-
CONVENTIONAL LOANS:				
MORTGAGE BANKERS	52.502	57.578	14.50	15.30
SAVINGS & LOANS	171.202	166.567	47.28	44.25
MUTUAL SAVINGS BANKS	30.637	33.720	8.46	8.96
COMMERCIAL BANKS	100.922	112.380	27.87	29.85
OTHER[1]	6.863	6.196	1.90	1.65
ALL LENDERS	362.125	376.441	-100-	-100-
FHA LOANS:				
MORTGAGE BANKERS	52.862	37.225	85.21	72.68
SAVINGS & LOANS	3.386	5.003	5.46	9.77
MUTUAL SAVINGS BANKS	.323	.397	.52	.78
COMMERCIAL BANKS	4.901	8.099	7.90	15.81
OTHER[1]	.565	.496	.91	.97
ALL LENDERS	62.038	51.220	-100-	-100-
VA LOANS:				
MORTGAGE BANKERS	26.264	15.290	85.02	69.87
SAVINGS & LOANS	1.485	2.252	4.81	10.29
MUTUAL SAVINGS BANKS	.148	.114	.48	.52
COMMERCIAL BANKS	2.790	4.072	9.03	18.61
OTHER[1]	.204	.154	.66	.70
ALL LENDERS	30.891	21.882	-100-	-100-

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1. Includes life insurance companies, private non-insured pension funds, state and local retirement funds, Federal credit agencies, and state and local credit agencies.

Source: HUD, Survey of Mortgage Lending Activity: First Quarter 1988 July 13, 1988.

Note: There are some small discrepancies (probably due to rounding) in the 1986 HUD numbers.

Prepared by: Thomas M. Holloway
MBA Economics Department
August 24, 1988

RESPONSES BY DR. KENT COLTON
NATIONAL ASSOCIATION OF HOME BUILDERS
TO QUESTIONS FROM
SENATOR DONALD W. RIEGLE, JR.

Hearing of March 10, 1989 on the
Financial Institutions Reform, Recovery
and Enforcement Act of 1989 (S.413)

Q.1. Taken as a whole, is the Administration's proposed legislation (S. 413) fair or unfair to the thrift industry?

A.1. NAHB believes that the proposed legislation (S. 413) is, on the whole, fair to the thrift industry. There are several provisions, however, that seem to be somewhat punitive in nature, and, while we understand this attitude, it should not be allowed to undermine the intent of the legislation to strengthen the thrift industry.

Q.2. If there is to be a separately regulated thrift industry, what purpose should it serve?

A.2. NAHB supports the existence of a separate home mortgage and housing production delivery system. Currently, that system is largely synonymous with a separately regulated thrift industry as specialized housing lenders, and, as such, should be continued.

Q.3. Under the Administration's proposal, a thrift institution that persistently fails the qualified thrift lender test would eventually be treated as a bank. Do you support that provision?

A.3. Yes, we support the requirement that a thrift that persistently fails the QTL test should be treated as a bank -- indeed, should change its charter to a bank. The QTL test is the standard by which a thrift's conduct of housing policy is measured. If a thrift is not carrying out its policy objectives as part of a special system, then it should not continue to benefit from that system. NAHB would like to see stronger sanctions, however, between the time a thrift fails the QTL test and the time it must convert to bank status.

Q.4. One rationale for placing the Federal Home Loan Bank System under the Treasury is to break up the historically close relationship between the thrift industry and its regulator.

Q.4.(a). Do you agree that is a desirable goal?

A.4.(a). Yes, NAHB agrees that it is appropriate to establish an arm's-length relationship between the thrift industry and its regulator, and this is why we support putting the regulatory structure under Treasury.

Q.4.(b). If the Federal Home Loan Bank System Chairman were independent of the Treasury, what would prevent that agency from being overly close to the industry?

A.4.(b). NAHB believes that, at this time, only the integrity of the Chairman and staff would prevent an overly close relationship between the industry and the agency were it to remain independent of Treasury. We realize that this closeness has been a traditional one engendered and encouraged by the special public policy purpose of the thrift industry. Unlike the banking regulatory agencies, the FHLBB's historical role has been to promote the interests of the industry it regulates. Clearly, this role is no longer appropriate, but it is likely to take considerably more time to change long-standing attitudes than to change the agency's structure.

Q.5. Should federally insured thrift institutions be prohibited from engaging, directly or through an subsidiary, in real-estate development?

A.5. NAHB opposes direct real estate investment activities by federally insured thrifts, because of concern about the safety and soundness of the nation's financial system. Federally insured deposits should not be used in this type of highly speculative and risky investment. Moreover, such activity requires builders to compete with development-involved institutions for limited funds.

NAHB supports legislation under which passive investments could be conducted in a nondepository affiliate or subsidiary, provided that the investments are structured as a financing arrangement, and the subsidiary has a non-controlling interest and no management authority.

Q.6. You argue that thrift institutions should be made subject to the uniform risk-based capital standards developed in accordance with the Basel Accord -- instead of having separate capital standards "not less stringent" than those applicable to national banks.

Q.6.(a). Some thrift representatives argue that the Basel Accord standards are designed for large commercial banks and cannot be applied to thrift institutions without modification. You evidently disagree. Explain why.

A.6.(a). In our view, simplicity and parity across types of depository institutions are keys to the implementation of risk-based capital rules and to industry restructuring -- an approach recognized by the Competitive Equality Banking Act of 1987 -- and are important for restoring confidence in the thrift system.

The Basel Accord provides capital rules that apply to an extensive range of assets, both on and off the balance sheet. That the Basel Accord takes into consideration types of assets peculiar to large commercial banks does not mean that they do not adequately address other common assets routinely found in thrifts as well as in banks of all sizes. The portfolios of thrifts and smaller banks tend to differ relatively little. If the Basel Accord standards were, in fact, designed specifically for large commercial banks, then it would strike us as equally inappropriate to apply them to small banks as well as to thrifts. In our opinion, the Basel Agreement provides a comprehensive and effective framework for capital levels in thrift institutions as well as in banks.

Q.6.(b). The Basel Accord standards focus on credit risk, rather than interest-rate risk. How would you control the interest-rate risk to which thrift institutions are exposed?

A.6.(b). FHLBB estimated that its proposed "interest-rate risk component" would generally add 2% of risk-based assets to the 6% minimum requirement. In our opinion, raising the Board's minimum requirement to 8% would be a far simpler means of adding that 2%. FHLBB already has risk management regulations in effect and has considerable supervisory leverage to deal with individual institutions that have exceptionally rate-sensitive portfolios.

NAHB believes that, to a considerable extent, interest-rate risk is implicitly included in the credit-risk weights of assets. Under the Basel Agreement, it is precisely the interest-rate risk associated with securities, for example, that led to the determination that individual national supervisors could set the risk weights of government and agency securities at any level between 0% and 50%. For example, FNMA and FHLMC securities pose virtually no credit risk; thus, the establishment of a risk weight of 20%, rather than 0%, by banking regulators and by the Board's proposal implies a recognition of interest-rate risk rather than a pure credit-risk factor in the weighting.

The weighting of high-quality single-family mortgages at 50% provides perhaps the clearest example. Both the banking rules and the Board's proposed rules require capital equal to 3% of the amount of such mortgages. The historical loss experience on these loans is only about 1%; consequently, the current risk weight provides three times more capital at a 6% requirement than would be deemed necessary to absorb losses based on credit risk alone. At an 8% minimum requirement, the capital backing these mortgages will be 400% of the actual loss experience.

This "margin of safety" contained within the credit-risk weights, combined with appropriate supervision, allows regulators to adequately address concerns about other risks, including interest-rate and asset concentration risk.

Q.6.(c). Do you agree that thrift institutions should be subject to the same accounting standards as banks?

A.6.(c). NAHB agrees that thrifts should be subject to the same accounting standards as banks, and we supported this position in the Competitive Equality Banking Act of 1987 as well.

Q.7. You suggest that the Administration's proposal places an undue burden on healthy thrift institutions and on the Federal home loan banks. From what other sources should the necessary funds be raised?

A.7. We wish to clarify that the thrift industry as a whole, including healthy institutions and the Federal Home Loan Banks, has a responsibility to shoulder as much of the financial burden for this proposal as is possible. Our concern is that the cost to the industry not create an undue burden. By this, we do not necessarily mean the amount of the costs per se, but the manner in which the costs are borne. Thus, NAHB supports longer and more orderly transitions under the plan so the industry can contribute to the costs at a pace that will not simultaneously undermine their ability to do so.

Q.8. What are your views on Congressman Barnard's proposed Real Estate Appraisal Reform Act?

A.8. There can be no doubt that inaccurate and, in some cases, fraudulent real estate appraisals have played a role in compounding the current thrift crisis. Clearly, the federal government has a legitimate interest in seeing that appraisals of properties involving federal loans or loan guarantees are accurate.

In view of that legitimate interest, NAHB views Congressman Barnard's efforts to get enacted a Real Estate Appraisal Reform Act as a positive step toward eliminating inaccurate and fraudulent appraisals from real estate transactions involving the federal government.

Although NAHB remains very concerned about the impact any new "user fees" on commercial real estate transactions would have on our industry, our efforts to date working with Congressman Barnard on crafting a mutually acceptable bill have been most satisfactory, and we look forward to continuing with him in this regard. NAHB is confident that Congressman Barnard will succeed in his effort to perfect a real estate appraisal reform measure which will achieve the purposes for which it has always been intended without placing an undue share of the burden for implementing the plan on the homebuilding industry.

THE WALL STREET JOURNAL WEDNESDAY, MARCH 1, 1989

FSLIC Funding Belongs Off-Budget

By **Martin Feldstein**

After years of government procrastination and counterproductive regulatory relief, the Bush administration is bringing the problem of the thrift industry under control. The $50 billion of up-front outlays will permit the government to fulfill its obligations to depositors while closing the currently insolvent thrifts or merging them into healthy financial institutions. The administration's proposals for tougher regulations, tighter supervision, and increased capital requirements reduce the risk that the thrift industry's problems will recur.

Although there are understandable doubts about the eventual cost of the plan, these uncertainties do not alter the fundamental soundness of the approach. It is important, moreover, to distinguish two different reasons costs may eventually exceed current estimates. First, extra capital may be needed if the number of insolvent thrifts eventually exceeds current projections. Second, the cost of servicing the newly created debt would also be higher than officially predicted if interest rates remain high or rise in the future. But the link between inflation and interest rates implies that much of the higher debt-service costs would be substantially offset by reductions in the real value of the remaining debt.

Investors' Worries

Among sophisticated investors here and abroad, the most serious concern is that the thrift plan adds some $50 billion to near-term government outlays without reflecting those outlays in the budget. They worry that the increased outlays will cause inflationary increases in demand and that the associated government debt will crowd out private borrowing. And those investors and financial analysts worry also that the accounting tricks used to hide the budget impact of the Federal Savings and Loan Insurance Corp. plan will make it difficult to control a wide range of debt-financed government spending in the future.

Although I usually am as concerned as anyone else about the effects of budget deficits, I do not worry that the debt-financed FSLIC outlays will add to aggregate demand or crowd out private borrowing. The proposed thrift-rescue plan is fundamentally different from other debt-financed spending because the outlays are essentially only a formal recognition of government liabilities that already exist. The $50 billion of new government outlays will therefore not cause spending on goods and services to rise and will not reduce the pool of funds available to finance private investments in plant and equipment or housing.

Consider first how the proposed thrift-rescue outlays will affect private spending on goods and services.

Those outlays will be paid either to depositors when an insolvent S&L is closed or to the investor (typically a healthy bank or thrift) that agrees to acquire a thrift in which liabilities exceed the market value of assets. Since a depositor who receives a government check to replace an account in a closed thrift is not made any richer or poorer by the transaction, the depositor's spending will remain unchanged. Similarly, when the government induces a healthy thrift to acquire an insolvent one by paying it the difference between the value of the failed thrifts' liabilities and the true market value of its assets (either directly or through tax breaks), the shareholders of the acquiring institution are neither enriched nor impoverished. They too have no reason to alter their spending.

Although tracing the flows of funds from the initial government payment to the final pattern of assets and liabilities may be complex, it is clear that there is no change in anyone's income, net worth or liquidity and therefore no reason to expect a change in the demand for goods and services.

An increased supply of government bonds usually crowds out private investment because the government bonds are assets that substitute in private portfolios for alternative privately issued assets. But in the case of the FSLIC rescue, the $50 billion of new government bonds are absorbed without crowding out any private borrowing because the rescue plan also creates $50 billion of offsetting private liabilities. In sharp contrast to the usual situation when there is a budget deficit, the ability of banks, thrifts and other lenders to provide credit to private borrowers is thus undiminished by the newly issued government bonds.

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The outlays will neither cause spending on goods and services to rise nor reduce the pool of funds available to finance private investments in capital goods or housing.

To understand why the plan creates offsetting amounts of assets and liabilities, consider first the case where FSLIC closes a thrift and pays off the depositors.

The insolvent thrift might have $100 million in deposits but assets worth only $60 million at market value in the form of mortgages and other loans. The government gives $100 million in cash to the depositors and acquires the portfolio of private mortgages and loans.

The depositors will place these funds in a variety of healthy thrifts and banks. Those institutions will then want to invest their newly acquired $100 million of deposits in interest-bearing assets. That increased demand for assets corresponds exactly to the $100 million of assets that the government will sell to the market—the $60 million of mortgages and loans and an additional $40 million of government bonds—to finance the $100 million in cash that it had to pay to the depositors. Although the institutions that receive the initial $100 million of new deposits might not want to hold the exact mix of assets that the government has to sell, the private market as a whole can absorb the additional $40 million of government bonds without cutting back on any of the private lending that it would otherwise have done.

The analysis is very similar if the government arranges to merge the insolvent thrift into a healthy thrift (or other healthy institution) instead of paying off the depositors. The insolvent thrift accepts $100 million in liabilities and $60 million in mortgages and other loans plus $40 million in cash. The government again sells $40 million in bonds and the acquiring thrift or other private institutions can absorb the $40 million of bonds without reducing the private lending that they would otherwise have done.

In short, $50 billion of FSLIC payouts financed by new government borrowing does not increase aggregate demand or crowd out private investment. It would be wrong therefore to count these payments in the Gramm-Rudman calculations and to adjust the desired path of taxes and spending to offset these payouts. The thrift-rescue payouts should be excluded from the Gramm-Rudman calculations just as the revenue received from the sales of government assets are now excluded. The administration's de facto exclusion of the thrift-rescue payouts from Gramm-Rudman is thus correct, and the worry of financial investors that the rescue plan is a hidden addition to the true deficit is misplaced.

There is, however, greater legitimacy to the concern that the administration's proposed method of off-budget financing may establish a dangerous precedent that weakens future budget discipline. Fortunately, it is a problem that can be remedied easily without changing the essential features of the administration's plan.

In its current form, the administration plan calls for the establishment of a new corporation—the Resolution Funding Corp.—that will borrow the $50 billion needed for the thrift rescue. Since the borrowing technically is not by the Treasury but by a separate legal entity, the rules of budget accounting permit the entire borrowing to be excluded from the budget.

Argument by Analogy

Although the special nature of the FSLIC payouts makes this off-budget treatment harmless, there undoubtedly is a danger that the same gimmick could be used inappropriately in the future to keep items off-budget that should be counted as part of the budget process. It is easy to imagine a future administration or Congress establishing a special corporation to carry out a major program of road construction or nuclear-waste cleanup with the resulting debt financed by future user fees. It would then be easy to argue by analogy with the thrift-rescue operation that such spending should be kept off-budget.

In fact, however, such a buy-now-pay-later program would be just the type of deficit finance that should be controlled by a Gramm-Rudman-type process. The government's construction outlays or nuclear cleanup efforts would increase aggregate demand, and the debt used to finance them would crowd out private investment. Private investors here and abroad are justified in their worry that the gimmick of a special off-budget corporation would be used to get around Gramm-Rudman-type controls in the future.

The best way to avoid establishing a precedent for uncontrolled deficit spending would be to drop the proposed Resolution Financing Corp. from the administration's plan and have the Treasury borrow the $50 billion directly. This borrowing would properly be recorded in the budget, but would be kept out of the Gramm-Rudman calculations on the correct grounds that the rescue plan would neither increase aggregate spending nor crowd out any private borrowing. It is critically important to emphasize this reason for keeping the borrowing out of Gramm-Rudman rather than to suggest that borrowing can be disregarded whenever the government arranges to have that borrowing done by a new special-purpose corporation.

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